April 2015

Edition

# THE THINGS THAT MATTER

## Introduction

### *Welcome to Argyle Lawyer's first 2015 newsletter*

We are pleased to provide you with the first 2015 edition of our newsletter "The Things that Matter".

Our aim is to provide you with updates on what we consider are some of the latest issues in taxation, superannuation, trusts, estate planning, commercial, property and family laws that you and/or your clients should be aware of.

If at any stage you wish to find out more about what has been outlined, or if you have any questions, please do not hesitate to contact one of our lawyers at your convenience.

Read on and find out more!

*Yours faithfully*

*The Argyle Lawyers Team*

**Subscription**

If you would like to subscribe to our newsletter, please send an email titled "*subscribe newsletter*" to: acrm@argylelawyers.com.au

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***KEY POINTS***

- **When giving important advice to your client, seriously consider buddying up with your lawyer to cloak your advice with Legal Professional Privilege.**

## *Legal Professional Privilege – Use it!*

The recent case of ***Donoghue v FCT* [2015] FCA 235** reinforces why all professionals must seriously consider the cloak of legal professional privilege when the advice (including tax advice) being provided is just too important to leave it or its deliberations potentially exposed to others, especially a government authority like the Australian Taxation Office (ATO) or Office of State Revenue (OSR).

The facts are quite straight forward. A law student working in conjunction with a law firm gained access to communications and documents which were made to the Taxpayer for the dominant purpose of obtaining legal advice for use in litigation.

This information 'made its way' to the Australian Taxation Office who, knowing that the communications and documents enjoyed legal professional privilege for the Taxpayer, nevertheless used the material as a foundation for raising Income Tax Assessments as well as departure prohibition orders.

The Federal Court of Australia overturned the assessments on the basis that the ATO's disregarding of the documents being subject to legal professional privilege amounted to conscious maladministration by the ATO.

It was on this basis that Logan J quashed the assessments under s39B of the *Judiciary Act 1903* (Cth) and restrained the ATO from using the materials subject to legal professional privilege in raising its income tax assessments.

## *If there is Legal Professional Privilege – Preserve it!*

The recent case of ***Krok v Commissioner of Taxation* [2015] FCA 51** highlights the risk of a client and/or its advisers inadvertently waiving legal professional privilege to documents and materials as part of discussions or litigation with a government authority.

The case provides a reminder that a taxpayer may impliedly waive its right to legal professional privilege by disclosing to the Commissioner of Taxation the 'gist, substance or effect' or 'purpose and reasoning' of advice which is subject to legal professional privilege.

The taxpayer had filed affidavits from advisors which referred to previous legal advice and background information / reasoning relating to structures and arrangements which had been put in place.

The Court acknowledged that the purpose of the taxpayer in disclosing the purpose and reasoning of the legal advice is to advance his case against the Commissioner of Taxation (ie, to achieve some forensic advantage in the proceedings).

On this basis, the Court held that it would be unfair to deny the other party (ie, the Commissioner of Taxation) an opportunity to review the full text of this advice which is subject to legal professional privilege. Privilege which would otherwise attach to the confidential communication has been waived.

This case highlights the importance of exercising extreme care in disclosing information or the nature of such information which is subject to legal professional privilege in discussions with the ATO or OSR (including in responding to their queries).

We provide below a ***Generic Disclaimer*** which may be sufficient depending on the client's circumstances:

***"I make this statement at the request, and with the express consent, of [Client]. However, I have no instructions from [Client] to waive privilege. To the extent that any part of this statement constitutes an inadvertent waiver of privilege, I withdraw that part of the statement."***

***KEY POINTS***

- **Exercise extreme care in disclosing information or the nature of such information which is subject to legal professional privilege in discussions with the ATO and OSR (including in responding to their queries).**
- **Do not inadvertently waive legal professional privilege.**
- **Consider disclaimers.**
- **If in doubt, seek professional legal advice!**

***KEY POINTS***

- **Now is the time to do a tax risk review of you or your client's tax affairs and asset portfolio (including those of related entities).**

## *ATO to increase audits of HNWIs*

The ATO has publicly announced that it will increase its target of high net wealth individuals and families in 2015.

The ATO's target will include baby boomers who are passing their wealth to the next generation.

The ATO will look for 'toys' such as yachts and planes that are incorporated into business expenses but are private assets as well as profit shifting to tax havens by private companies.

Michael Cranston of the ATO said that many privately owned businesses did not separate their private assets from business affairs.

The ATO has already singled out 175 family groups with turnover of $1b or more and $500m in assets.

The ATO has updated its website on the behaviors, characteristics and tax issues associated with privately owned and wealth groups which attract its attention.

These factors include:

- tax or economic performance is not comparable to similar businesses
- low transparency of your tax affairs
- large, one-off or unusual transactions, including transfer or shifting of wealth
- a history of aggressive tax planning
- tax outcomes inconsistent with the intent of tax law
- choosing not to comply or regularly taking controversial interpretations of the law
- lifestyle not supported by after-tax income
- treating private assets as business assets
- accessing business assets for tax-free private use
- poor governance and risk-management systems.

*For more information:*
https://www.ato.gov.au/general/building-confidence/privately-owned-and-wealthy-groups/transparency/what-attracts-our-attention/

## *A refresher on Australian Tax Residency*

The recent cases of ***Dempsey v Commissioner of Taxation*** **[2014] AATA 335** and ***The Engineering Manager v Commissioner of Taxation*** **[2014] AATA 969** have shed some further light into the evolving Australian jurisprudence on defining the boundaries of when one is considered a "resident" for Australian tax purposes.

There seems to be a shift in the AAT's focus – from the simple exercise of identifying and weighing up discrete "factors" for and against residency - to a fulsome consideration of the taxpayer's particular facts and circumstances in totality. As scary as it might sound, one's entire life story (for at least the audited tax periods in question) is canvassed by tribunal of fact in determining whether one "resides" in Australia or whether one has "established a permanent place of abode outside of Australia".

Here is some food for thought that has arose from these cases.

Dedication to one's work or career in an overseas country could override familial ties back in Australia.

Maintaining a property in Australia does not necessarily indicate that couldn't have a permanent place of abode outside of Australia, so long as there are good reasons for retaining it!

One's marital status (whether married, separated or divorced) can have a very significant factor in determining your tax residency – for better or for worse!

The importance of information completed by the taxpayer on passenger immigration cards in determining Australian tax residency status has been thrown in doubt.

***KEY POINTS***

- **Courts have shown some willingness in considering the totality of a taxpayer's particular circumstances to assess residency, rather than on a "weighting up" of discrete factors.**
- **Recent cases have given us tax practitioners some food for thought.**

***KEY POINTS***

- **Industry practice will be relevant when construing contractual obligations to use best or reasonable endeavours.**

## *Commercial contracts – Reasonable or Best Endeavours Clauses clarified*

Many contracts include a provision that requires a party to **use its 'reasonable endeavours' or 'best endeavours'.** What do these phrases mean and are they different?

The recent case of ***Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640; [2014] HCA 7**, considered these terms are of a similar type of obligation and will be seen as of the same nature for the purpose of interpretation. So no difference in meaning.

The decision in *Electricity Generation Corporation v Woodside Energy Ltd* has confirmed that an objective approach to interpretation is favoured and that the 'true rule' of interpretation set down in ***Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337** (at 350) is no longer a favoured approach as it struggles in some circumstances to give business efficacy to a commercial contract.

What this means for parties entering into a commercial contract is that, 'best endeavours' or 'reasonable endeavours' will be construed in light of its particular industry and be viewed by what a reasonable business person in that industry would construe it to mean. A 'reasonable endeavours' or 'best endeavours' clause will not oblige the party bound by the clause to go as far as to sacrifice their own business interests as the approach is aimed at maintaining business efficacy of a contract for both parties.

## *Another Superannuation BDBN failure*

Another year and yet another Superannuation Binding Death Benefit Nomination (BDBN) failure.

In 2009, it was ***Donovan v Donovan* [2009] QSC 26**. Now in 2015 it is ***Munro & Anor v Munro & Anor* [2015] QSC 061**.

There are lessons to be learnt from both of these cases, which involve protagonist of the same surnames.

If you are drafting a Superannuation BDBN, which is a legal document:

**1. Read the trust deed**

Fryberg J did this in 2009 in the Donovan decision and found that the design of the deed import SIS Reg 6.17A which is why the nomination failed. Mullins J did this in 2015 in the Munro decision and found that the design of the deed did not import SIS Reg 6.17A but the nomination failed anyway.

**2. Read the trust deed**

Get your language right in terms recognised by the trust deed. In Munro, the nomination was in favour of the '*Trustee of the Deceased Estate*'. This doesn't identify anybody.

Executors act under probate. Administrators act under letters of administration. Both become trustees of the assets of the estates if their role is complete and they retain these, but they are not trustees of a deceased estate.

**3. Read the trust deed**

The nomination form must be construed on its face and having regard to its purpose. It is not appropriate to construe the nomination form by reference to the will when the nomination is for the purpose of payment of the death benefit from the fund.

**4. Read the trust deed**

In this case, there was no power given to the trustees under the trust deed or otherwise to dispense with compliance with the conditions for a binding death benefit nomination.

**5. Read the trust deed**

Especially if you advise on BDBNs. The Court in Munro observed that the "accountants … organised for the trust deed".

***KEY POINTS***

- **Read the Trust Deed when drafting Superannuation BDBN.**
- **Understand that Superannuation BDBN are *legal documents*. Does your professional insurance cover you in providing legal advice or undertaking legal work?**

The Court also found that the accountants prepared the form which the deceased signed and was the subject of the case.

Understand that BDBNs are legal documents. If you are an accountant drafting legal documents, does your professional insurance actually cover you in undertaking legal work?

*KEY POINTS*

- **Proper disclosure and documentation is key.**
- **Access to the Small Business CGT Concessions clarified.**
- **GST – too early for registering for an ABN / claiming input credits?**
- **ATO's self-imposed time limit on issuing original trustee assessments.**
- **Income according to ordinary concepts vs income of a capital nature in the context of property development.**

# *Further updates of April 2015*

For the month of April, some of the other matters that may be of interest to you may include:

***Gui Ping Wu v Commissioner of Taxation* [2015] AATA 78**

This AAT decision is a stern reminder for taxpayers to properly disclose their overseas interests in light of the Commissioner's information sharing abilities with government agencies such as AUSTRAC and to keep proper documentation of your overseas business interests.

In this case, the taxpayer, who did not declare assessable income from overseas sources, had his bank deposits assessed as his income. Due to the lack of proper evidence of his overseas business interests, the taxpayer was unable to prove that his amended assessments, which asserted that the money transfers as extracted from AUSTRAC was assessable income, were excessive.

**ATO ID 2015/8**

This ATO ID confirms that a trust (such as a unit trust) which gives the trustee the power to accumulate income or capital of the trust estate for a year of income is entitled to be considered a 'trust' for the purposes of Item 2 of the table in subsection 152-70(1) of *the Income Tax Assessment Act 1997*.

This is relevant because in order to access the small business CGT concessions, a determination of an entity's small business participation percentage in a trust must be calculated based on which entities have entitlements to all of the income and capital of the trust pursuant to Item 2 of the table in subsection 152-70(1) of *the Income Tax Assessment Act 1997*.

***Bryxl Pty Ltd as Trustee for the Kypu Trust v Commissioner of Taxation [2015] AATA 89***

This case acts as a reminder that taxpayers should be prudent in ensuring they are carrying on an enterprise prior to claiming input tax credits for GST purposes. The input tax credits in this case were disallowed.

The taxpayer's actions in obtaining a planning permit and market valuation were preliminary steps in the course of commencing a business of property development. However, in the absence of any ownership of land or at least a binding contract for the purchase of the land to carry out the property development, no enterprise had been carried on at the time.

***PS LA 2015/2 – Trustee assessments***

This Practice Statement outlines the ATO's practice of limiting the period within which the Commissioner will raise an original trustee assessment (despite the technical position that the Commissioner has unlimited period in which to review and assess the trustee's tax position).

As such, generally speaking, where a trustee lodged a trust tax return for the year in question and the Commissioner is of the opinion that there is no fraud or evasion or there are no other circumstances that allow for an extended or unlimited amendment period, an original trustee assessment (for that year in question) should not be issued more than four years after the trust tax return for that year was lodged or two years, if the trust is a small business entity and none of the qualifications in item 3 of the table in section 170(1) apply.

***Decision Impact Statement – August v Commissioner of Taxation***

This Decision Impact Statement outlines the ATO's response to *August v Commissioner of Taxation* (2013) ATC 20-406 on whether the profit from the sale of properties was income according to ordinary concepts or income of a capital nature. In the circumstances of that case, it was held that the profits on sale of the "Melba shops" and the "Hume property" was income according to ordinary concepts, and not on capital account (and whereby the taxpayer could have assessed the Division 115 discount capital gains).

The ATO's response is that the Full Court applied settled principles of law to the facts in the case.

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