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Case Notes

December 2016

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"The hardest thing to understand in the world is the income tax"
Albert Einstein

MNWA Pty Ltd v Deputy Commissioner of Taxation:

No error in failing to set aside statutory demand for tax debts as no global deal

Introduction

A company seeking to set aside a statutory demand that relates to a tax debt will rarely, if ever, be able to establish that there is a genuine dispute about the existence or amount of the tax debt.[1] It will need to show "*some other reason*" why the demand should be set aside. Despite the apparent breadth of those words, the circumstances in which a demand will be set aside for some other reason are limited by the material considerations[2] that must be taken into account. The taxpayer companies in the recent Full Federal Court case of *MNWA Pty Ltd v Deputy Commissioner of Taxation,*[3] despite novel arguments, were unable to pass the threshold.

Facts

In September 2014, MNWA Pty Ltd (**MNWA**) was issued a statutory demand under s 459E of the *Corporations Act 2001* for payment of GST totalling $5,462, 889. Another company, Gucce Holdings Pty Ltd (**Gucce**), was also issued a statutory demand for income tax, SIC and GIC totalling $3,796,160.01.

MNWA and Gucce (**the companies**)[4] unsuccessfully applied[5] to set aside the statutory demands under s 459J(1)(b).[6] The "other reason" relied upon by the companies was that the issuing of the demands was unconscionable, an abuse of process and in breach of, and an unconscionable departure from, an agreement made with the Commissioner at a meeting in April 2014. The agreement was that the Commissioner would not, subject to appropriate security being provided, pursue recovery of the companies' tax and GST liabilities, while they pursued objection and appeal rights under Part IVC of the *Taxation Administration Act 1953*. The Commissioner and the companies entered into deeds of agreement under which the Commissioner agreed not to recover certain tax liabilities provided the companies provided certain security, which they did. The tax liabilities covered by the deeds of agreement were different to the tax debts sought to be recovered pursuant to the statutory demands.

First instance decision

At first instance, relying on *NT Resorts Pty Ltd v Deputy Commissioner of Taxation,*[7] the companies argued that the demands should be set aside under s 459J(1)(b) if the Court was satisfied that there was a genuine dispute about

whether the agreement covered the tax debts to which the statutory demand related. The companies argued that a genuine dispute would exist if it was reasonable and arguable or plausible that the Commissioner had agreed to defer recovery action of the tax debts the subject of the statutory demands. It was not necessary, in the companies' submission, for the Court to decide whether there was in fact such an agreement.

The primary judge found that the evidence did not establish on the balance of probabilities that a global agreement had been made covering the tax debts the subject of the statutory demands. Griffiths J also rejected the companies' claim that the Commissioner had served the demands for an improper purpose or that he had engaged in unconscionable conduct by serving the demands.

Appeal grounds

On appeal to a Full Court,[8] the companies raised a number of grounds of appeal. In summary, they were:

1. *Wrong findings of fact:* the trial judge erred in finding that there was no binding oral global deal that the Commissioner would not take recovery action; and

2. *Improper application of s 459J(1)(b):* the trial judge applied the wrong test for determining whether there was some other reason; having found there was a genuine dispute about the existence of a global deal, the trial judge should have found there was a genuine dispute as to whether the debt was immediately payable.

Full Court decision

Based on these grounds, a majority[9] of the Court distilled the following issues to be decided:

A. Whether the alleged "global deal" had to be established on the balance of probabilities (as Griffiths J held), or whether, as the companies submitted, it was enough to show a genuine dispute about the existence of such a deal warranting the demand being set aside for some other reason; and

B. Whether the trial judge made wrong findings of fact in deciding that the companies had not established the existence of a global deal.

Issue A: standard of proof

The majority rejected a preliminary submission made by the companies that the primary judge failed to deal with an argument that the companies' debts were not immediately due and payable when the demands were served because of the global deal that existed. The Court found that the primary judge had dealt with the argument and dismissed it. The onus was more than establishing an arguable case: where abuse of power of collateral purpose (in issuing the demand) is raised, that has to be established on the balance of probabilities. The majority noted in any event that the companies were prevented from arguing that the debts were not immediately due and payable when the demands were served based on *Broadbeach*.

Next, a submission that the primary judge erred in embarking on a trial of the "significant dispute" about whether a global deal existed was rejected. The majority held that no such finding was made, rather that his Honour merely stated the Commissioner's rejection of such a global deal and in any event, there was no reasonable basis for finding that a global deal had been made. Importantly, the majority said:[10]

> Given the statutory scheme for collection and recovery of tax, an arguable basis for disputing the Commissioner's right to take recovery action is insufficient to constitute "some other reason" within the terms of s 459J(1)(b) and does not support an exercise of power to set aside the statutory demands under that section.

Issue B: factual findings

The companies submitted that the primary judge erred in finding that there was no global deal covering the debts the subject of the demand due to defects in consideration of the evidence, the creditworthiness of the Commissioner's witnesses and contrary evidence suggesting those witnesses were not telling the truth.

The majority considered that the finding as to the non-existence of a global deal was not based solely on the evidence of the Commissioner's officers which was preferred over the companies' witnesses. The objective contemporaneous documentary evidence of the meeting (including detailed meeting notes) at which the global deal was alleged to have been made was critical. An allegation that the ATO witnesses had colluded in giving their evidence was rejected.

Conclusion

The key take-away for both taxpayers and the revenue is that contemporaneous objective documentary evidence of "deals" relating to the payment of tax will be critical in any subsequent dispute. There will rarely, if ever, be a genuine dispute about the existence or amount of a tax debt or whether it was due and payable. A company seeking to set aside a demand relating to tax will need to rely on some other reason which must be established on the balance of probabilities.

By Mark Mathews, Special Counsel

Bywater Investments & Hua Wang Bank Berhad v Commissioner of Taxation:

Corporate tax residency determined by location of central management and control not where board located

Introduction

Is the overseas location of the board of directors determinative of the non-residency of a company for the purposes of determining liability to Australian income tax? Emphatically, the answer is "no" based on the High Court's recent decision in *Bywater Investments Limited v Commissioner of Taxation; Hua Wang Bank Berhad v Commissioner of Taxation.*[11]

A company that is not incorporated in Australia, but which carries on business in Australia and has its central management and control in Australia, will be a resident of Australia for income tax purposes.[12]

Facts

In this case, the companies were all incorporated overseas. They all had directors who lived overseas. The board of directors met overseas. However, critical to the outcome was the factual finding that a Sydney resident controlled and made all company decisions and ran all aspects of the companies' business – Sydney was the real place of central management and control. The board meetings merely rubber stamped the decisions made independently by the Sydney resident and did not constitute an independent exercise of decision-making power. This was so, notwithstanding the outsider's lack of legal power to control the board.

In this case, despite the board of directors being overseas and directors meetings being held overseas, central management and control (and therefore residency) was, as a matter of fact and degree and having regard to the course of business and trading, located where the company's operations were controlled and directed. That location was Sydney, being the place of residence of the individual who made and directed the decisions of the relevant companies, and hence, the location of central management and control.

High Court decision

The High Court affirmed and explained the proposition from *Esquire Nominees Ltd v Federal Commissioner of Taxation*,[13] that a company is resident where its real business is carried on and its real business is carried on where the central management and control is located, which is a question of fact and degree. In particular, the High Court observed:

- A company will not be taken to be resident where its board meetings are held, even if those meetings rubber stamp decisions made somewhere else;

- A company will not be taken to be resident where its board of directors meet unless some other person has a legally enforceable power to control the board and its decision-making
- The absence of legal power to control the board is not determinative of whether the board is actually itself exercising central management and control
- A company should not be regarded as resident outside Australia merely because it has established an overseas board to act at the direction of an Australian resident
- The question of where central management and control resides is one of fact and degree

In short, the High Court found that a Sydney man dictated the business activities of the overseas companies from Sydney and the various boards of the companies did exactly as he directed them. Accordingly, central management and control was in Sydney and therefore the companies were residents of Australia for tax purposes.

Conclusion

It is not sufficient for a board to go through the motions of exercising independent judgment and decision-making in order to establish the location of the board as the place of central management and control. There has to be real and substantive decision-making, not mere "rubber stamping" which was not the case in *Esquire Nominees.*

The location of directors, the board and board meetings will not be determinative of the place of central management and control and hence the residency of a corporation. What is critical, as a matter of fact and degree, is the location where real and effective decision-making power is exercised. It is this location which will be the place of central management and control and the determinant of the place of corporate residency for Australian income tax purposes.

Forthcoming

Given the recent focus on corporate residency created by the High Court decision in *Bywater*, we turn our attention in the New Year to the often vexing question of individual tax residency. Watch out for our upcoming seminar paper on individual tax residency and a review of recent tax residency cases. We will examine the statutory residency tests and how they have been applied in practice. What can be learnt from the sometimes apparently conflicting decisions on similar facts?

By Mark Mathews, Special Counsel

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[1] *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* (2008) 237 CLR 473 at 495-496 [57], [2008] HCA 41; *Hoare Bros Pty Ltd v Commissioner of Taxation* (1996) 62 FCR 302 at 311, [1996] FCA 1234.
[2] As to which see *Deputy Commissioner of Taxation v Broadbeach Properties Pty Ltd* (2008) 237 CLR 473 at 497 [61].
[3] [2016] FCAFC 154.
[4] The companies were related only in the sense that Mr Caratti, the owner and controller of MNWA, is the de facto partner of Ms Bazzo, the owner and controller of Gucce.
[5] Pursuant to s 459G(1) of the *Corporations Act 2001 (Cth).*
[6] *MNWA Pty Ltd v Deputy Commissioner of Taxation (No 2)* [2015] FCA 1128.
[7] [1998] FCA 255.
[8] Rares, Farrell and Davies JJ.
[9] Farrell and Davies JJ.
[10] [2016] FCAFC 154 at [192].
[11] [2016] HCA 45.
[12] *Income Tax Assessment Act 1936*, s 6(1).
[13] (1973) 129 CLR 177; [1973] HCA 67

About the author

Mark Mathews

Special Counsel

Mark Mathews, CTA was admitted to practise as a legal practitioner and barrister of the High Court of Australia and Federal Court of Australia in 2001.

With over 25 years in the tax profession, Mark brings a wealth of tax advisory and tax dispute resolution experience spanning a broad range of markets and industries.

Having worked for a number of Big 4 and mid-tier accounting and law firms and practising as a revenue law barrister, Mark has extensive experience in providing commercial, lawful and practical tax advice to large corporates, SME's and high wealth individuals.

Mark also specialises in tax dispute resolution. He has negotiated the settlement of major tax disputes and run complex tax litigation in the Federal Court of Australia and the Administrative Appeals Tribunal. Mark has acted for taxpayers and the Commissioner of Taxation.

Prior to entering private practice, Mark was Tax Counsel in the ATO. Mark's extensive experience at the ATO, spanning over 13 years in policy, technical and litigation areas, has given him a unique insight into the ATO's approach to tax law interpretation, administration and litigation.

Qualifications

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