

Case Notes

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In This Issue

- *TVKS and Commissioner of Taxation*
- Commissioner's Remedial Power

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"When there is an income tax, the just man will pay more and the unjust less on the same amount of income"

Plato

TVKS and Commissioner of Taxation:

Taxpayer unsuccessful in seeking to amend grounds of objection to rely on alleged disclaimer of entitlements to trust income

Introduction

The recent decision of the Administrative Appeals Tribunal (AAT) in *TVKS and Commissioner of Taxation*¹ is a salutary reminder of the need to state fully and in detail the grounds of objection relied upon.² A taxpayer seeking to amend their grounds of objection will not usually be permitted to do so where prejudice is caused to the Commissioner. The case also highlights yet again the need for a disclaimer of a trust entitlement to be made in a timely manner otherwise the disclaimer will fail, as occurred in this case.

Facts

The Woodchester No 4 Trust

The Woodchester No 4 Trust's accounting profit for the year ended 30 June 2006 was \$10,374,993. On 30 June 2006, the trustee resolved to distribute 100% of the income of the Trust to TVKS.

In the Trust's tax return for the 2006 year, net income of \$676,209 was disclosed but carried forward tax losses of \$11,053,152 were applied to reduce the net income to nil. An amendment request was made to increase the Trust's net income to \$10,108,621 with the Trust's losses being applied to reduce this amount to nil.

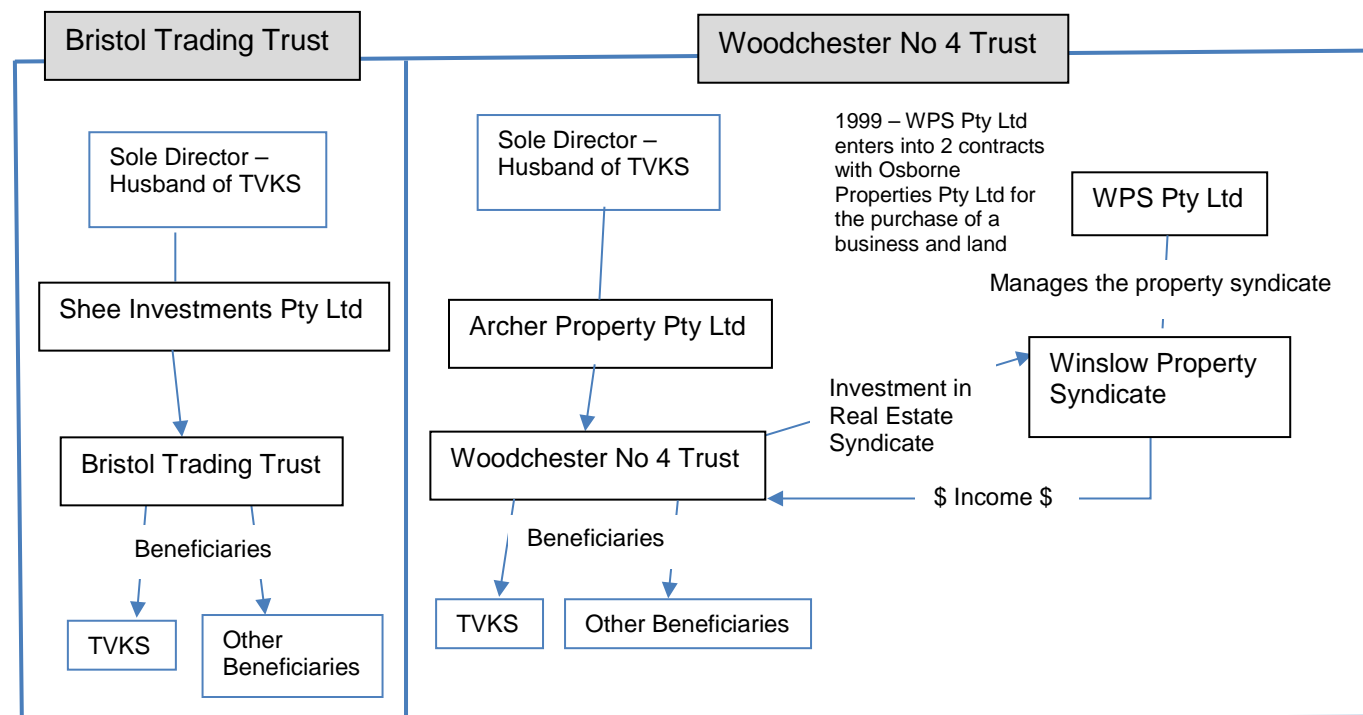
Accordingly, TVKS did not return any amount as a distribution from the Woodchester No 4 Trust in respect of the year ended 30 June 2006.

The Bristol Trading Trust

The Bristol Trading Trust's accounting profit for the year ended 30 June 2007 was \$6,643,498. On 30 June 2007, the trustee resolved to distribute the income of the Trust to TVKS in respect of the first \$3.5 million and the remainder to a related company.

TVKS did not return any amount as a distribution from the Bristol Trading Trust in respect of the year ended 30 June 2007.

The facts are depicted in the following diagram:



The Commissioner's Audit

The Commissioner conducted an audit of TVKS' husband and associated entities which focused on the years ended 30 June 1999 to 2009 inclusive.

In respect of the 2006 income year, the Commissioner concluded that the Woodchester No 4 Trust did not incur a substantial tax loss in 1999. The net income of the Trust in 2006 was therefore \$10,108,621. As TVKS was presently entitled to 100% of the trust's income, she was therefore assessable on the entirety of the trust's net income pursuant to the provisions in Division 6 of the *Income Tax Assessment Act 1936 (ITAA36)*.

In respect of the 2007 income year, the Commissioner also concluded that the Bristol Trading Trust did not incur a substantial tax loss in 2000. The net income of the Bristol Trust for this year was therefore \$3,143,510. Given TVKS' present entitlement to the income of the trust, she was assessable on the entirety of the trust's net income.

Following a request by the Commissioner, TVKS signed a number of consents agreeing to extend the period within which her assessments could be amended pursuant to s 170(7) of the ITAA36.

Notices of amended assessment were issued to TVKS on 14 May 2013 for the 2006 and 2007 years.

The Taxpayer's Objection

On 5 July 2013, TVKS objected to the amended assessments. Her objection was allowed in part to the extent that the Woodchester No 4 Trust was allowed a deduction of \$230,000. The objection was otherwise disallowed.

Disclaimer

On 14 December 2015, TVKS executed separate deeds purporting to retrospectively disclaim her interest in the Woodchester No 4 Trust and the Bristol Trading Trust with effect from 1 July 2005.

Questions at Issue

TVKS asked the AAT to review the Commissioner's objection decision. The AAT considered that the following issues arose on the review:

1. Whether TVKS should be given leave to amend her grounds of objection to:
 - i. rely on the purported disclaimers of her trust entitlements; and
 - ii. argue that trust resolutions were defective.
2. Whether the consents given by TVKS pursuant to s 170(7) of the ITAA36 were invalid on the basis that the Commissioner had not started to examine her taxation affairs at the time the consents were given.

Decision

The Deputy President confirmed that a taxpayer can only validly consent to extend the period within which their assessment can be amended pursuant to s 170(7) of the ITAA36 when the Commissioner has started to examine the affairs of that taxpayer in relation to that particular assessment. In this case, as the ATO audit concerned the affairs of TVKS' husband and his related entities (including the Woodchester No 4 Trust and the Bristol Trading Trust), the Commissioner had commenced his examination of TVKS' taxation affairs at the time the consents were provided.

Deputy President Forgie declined to grant leave to TVKS to extend the grounds of her objection to allow her to rely on the disclaimers as doing so would prejudice the Commissioner in carrying out his statutory function to administer the taxation laws. The Commissioner was entitled to deal with TVKS' affairs as they stood at the relevant times.

The Deputy President found that even if she had permitted TVKS to extend her grounds of objection to rely on the disclaimers, the passage of a significant period of time was consistent with an intention by TVKS not to disclaim her interest in the distributions. The Deputy President referred to the relevant principles enunciated in *Commissioner of Taxation v Ramsden*,³ including the following:

1. At law an effective disclaimer operates retrospectively, and not merely from the time of disclaimer.⁴
2. A beneficiary may not disclaim if he or she has accepted the distribution. A beneficiary will be taken to have accepted the interest where the beneficiary is made aware of it and does not, before a reasonable time has elapsed, seek to disclaim it.⁵
3. A beneficiary of a discretionary trust may disclaim for each exercise of the discretion. The fact that the beneficiary has accepted benefits previously does not bar a disclaimer in respect of later exercises of the discretion.⁶

Deputy President Forgie declined to grant leave to TVKS to extend the grounds of her objection to allow her to argue that the Trust resolutions were defective. She considered that this would prejudice the Commissioner as the consequence of TVKS successfully arguing that the resolutions were defective would be a trustee assessment pursuant to s 99A of the ITAA36. The Commissioner's ability to recover the tax payable on such assessments would be prejudiced if leave to amend was granted.

Conclusion

A taxpayer seeking to disclaim an entitlement to trust income will be taken to have accepted a trust distribution, and may not disclaim that interest, if they are aware of the distribution and do not seek to disclaim it within a reasonable time.

By Leon Mahtani, Solicitor & Mark Mathews, Special Counsel

Commissioner's Remedial Power

Introduction

On 1 May 2015, the Assistant Treasurer announced that the Government would provide the Commissioner of Taxation (**the Commissioner**) with a statutory remedial power to allow for the timely resolution of unforeseen or unintended outcomes in the application of taxation and superannuation laws.⁷

To give effect to the measure, the Tax and Superannuation Laws Amendment (2016 Measures No. 2) Bill 2016 was introduced in the House of Representatives on 17 March 2016. The bill lapsed on prorogation, but was reintroduced to the House on 14 September 2016.⁸ The Bill subsequently received Royal Assent on 28 February 2017.

The remedial power applies from the day after the Bill received Royal Assent, 1 March 2017. The legislation (passed as the *Tax and Superannuation Laws Amendment (2016 Measures No. 2) Act 2017*) establishes the statutory remedial power in a new Division 370 of Part 5-10 of Schedule 1 to the *Taxation Administration Act 1953* (TAA1953). The operative provision is section 370-5 of Part 5-10 of Schedule 1 to the TAA1953.

The Commissioner's Remedial Power

The statutory remedial power permits the Commissioner to modify the operation of the taxation and superannuation law by making a legislative instrument to ensure the purpose of the law is achieved. The power can only be validly exercised where:

1. the modification is not inconsistent with the intended purpose or object of the provision;
2. the Commissioner considers the modification to be reasonable, having regard to both the intended purpose or object of the relevant provision and whether the costs of complying with the provision are disproportionate to achieving the intended purpose or object; and
3. the Department of the Treasury or the Department of Finance advises the Commissioner that any impact on the Commonwealth budget would be negligible.

Modification

A modification to a taxation law does not include a textual amendment to the relevant taxation law and does not permit the Commissioner to alter the purpose or object of the law. It only allows the Commissioner to modify the operation of a provision of the taxation law where that modification satisfies the above three requirements. The modification will only apply to the extent that it is favourable to entities. An entity will need to self-assess whether a particular modification in a legislative instrument is favourable to that entity.

An example of a modification is where a class of taxpayers do not satisfy a condition for a capital gains tax (**CGT**) roll-over, despite the purpose of the roll-over clearly being to benefit that class of taxpayers. A legislative instrument may be made with respect to the application of the CGT rollover, such that the condition does not need to be satisfied by the relevant class of taxpayers.

Another example of a modification is provided in the proposed new s 370-1.

After a provision of a taxation law is enacted, it is found that, because of developments in the practices of businesses or the Commissioner [sic], the provision imposes disproportionate compliance costs on taxpayers. The Commissioner might, under this Division, be able to modify the operation of the provision to give timely relief.

Legislative instruments

Legislative instruments are to be drafted, developed and consulted on in accordance with the requirements of the *Legislation Act 2003* (Cth) to give effect to the exercise of the remedial power. According to the Explanatory

Memorandum, the Commissioner must be satisfied that appropriate and reasonably practicable consultation has been undertaken before exercising the power. Information with respect to a public consultation process is expected to be released by the ATO in due course.

Legislative instruments made pursuant to the remedial power are disallowable by either House of Parliament. Review by the courts will be available where a taxpayer considers an exercise of the power is beyond the Commissioner's jurisdiction. An instrument remains in force for a period of ten years.

A legislative instrument made by the Commissioner under the remedial power applies in relation to all entities, or, if stated in the determination, to a specified class of entities or in specified circumstances. The remedial power cannot be used to modify the operation of a taxation law for a particular entity.

By Leon Mahtani, Solicitor & Mark Mathews, Special Counsel

¹ [2016] AATA 1010 (9 December, 2016; Deputy President S A Forgie).

² *Taxation Administration Act 1953*, s 14ZU.

³ [2005] FCAFC 39.

⁴ Above n 3, [30].

⁵ Above n 3, [55].

⁶ Above n 3, [26]; *In re Gulbenkian's Settlement (No 2), Stephens v Maun* [1970] 1 Ch 408.

⁷ Media Release, The Hon Josh Frydenberg MP, Assistant Treasurer, "Providing more certainty and better outcomes for taxpayers", 1 May 2015: <https://jaf.ministers.treasury.gov.au/media-release/021-2015/>.

⁸ House Bills List as at 12 December 2016.

About the authors



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.

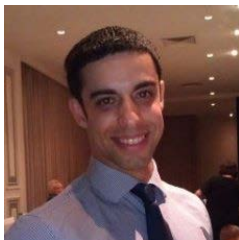
Prior to entering private practice, Mark was Tax Counsel in the ATO. Mark's extensive experience at the ATO, spanning over 13 years in policy, technical and litigation areas, has given him a unique insight into the ATO's approach to tax law interpretation, administration and litigation.

Qualifications

Grad Dip Legal Practice (Distinction)

LLB (Hons)

B Comm

**Leon Mahtani**

Solicitor

Leon Mahtani CTA is a lawyer with over nine years of taxation law experience gained working for a mid-tier accounting firm and at the ATO.

Leon has experience providing tax advice to taxpayers, including in respect of the small business capital gains tax concessions, the income tax implications of property development, tax residency and the taxation of trusts. He also specialises in tax dispute resolution. Prior to joining private practice, Leon was the Manager of the Sydney team at the ATO responsible for determining taxation objections lodged by High Wealth Individual taxpayers.

Leon also acts in debt recovery and insolvency matters in both State and Federal courts.

Leon is the Chair of the Taxation Law Committee (Law Society of NSW Young Lawyers Branch) and is a Committee Member of the Law Society of New South Wales/Office of State Revenue Liaison Committee.

Qualifications

Bachelor of Commerce/Bachelor of Laws (Honours) – Macquarie University

Master of Laws in Corporate, Commercial and Taxation Law – UNSW

Master of Professional Accounting – UTS