# *IT 2462 - Income tax : trust stripping - income from family trust distributed to a trust owned by the taxpayer's accountant. distributed amount returned to the family trust in the form of an interest free loan repayable on demand.*

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There is an Addendum notice for this document.

This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

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# TAXATION RULING NO. IT 2462

INCOME TAX : TRUST STRIPPING - INCOME FROM FAMILY TRUST DISTRIBUTED TO A TRUST OWNED BY THE TAXPAYER'S ACCOUNTANT. DISTRIBUTED AMOUNT RETURNED TO THE FAMILY TRUST IN THE FORM OF AN INTEREST FREE LOAN REPAYABLE ON DEMAND.

F.O.I. EMBARGO: May be released

REF N.O. REF: 87/5633-3, 87/7652-1, 87/7671-7 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

| REFERENCE NO: | SUBJECT REFS: | LEGISLAT. REFS: |
|---|---|---|
| I 1010379 | TRUST STRIPPING | 260 |

OTHER RULINGS ON TOPIC IT 2059 and 2102

PREAMBLE In a decision given on 13 November 1987 (unreported) the Administrative Appeals Tribunal (Deputy President C.J. Bannon QC and Messrs C.J. Stevens and G.R. Taylor, Members) recently considered whether an attempt by a trustee of a family trust to distribute income to another trust controlled by the taxpayers' accountant, together with a loan agreement with another party whereby the money distributed would come back to the family trust, was an effective method to minimise the taxation liabilities of the taxpayers. The Tribunal concluded that the arrangement comprehensively failed to achieve its tax minimisation purpose.

FACTS 2. The male taxpayer commenced business in 1973. On 4 June 1979 a family trust was created by deed. The trustee was a private company of which the sole shareholders and directors were the husband and wife taxpayers. The beneficiaries named in clause 2 of the deed were the husband and wife taxpayers and "their children, grandchildren and any other beneficiaries whom the trustee may from time to time determine".

3. Towards the end of the year ended 30 June 1980 the husband foresaw that the trust would be in receipt of substantial income and approached his accountant for advice about minimising the tax liability.

4. The accountant recommended introduction of one of his own trusts as a beneficiary to receive the bulk of the taxable income. This amount would eventually be returned to the family trust via another entity of the accountant in the form of an interest free loan repayable on demand. Repayment was not envisaged within the foreseeable future.

5. The accountant had at least 117 like named trusts differentiated by the use of numbers.

6. By resolution on 13 June 1980, purportedly in pursuance of clause 7 of the family trust deed, clause 2 of the deed was deleted and a new clause 2 was inserted stating that the beneficiaries were the husband and wife, their child and the accountant's trust (unnumbered). On that same date a deed of variation of trust was executed by the trustee company to carry out the resolution.

7. The scheme also required an agreement dated 25 June 1980 whereby the trustee company agreed to borrow $90,000 from the trustee of the accountant's No.86 trust and to accept a bill of exchange in settlement of the loan principal.

8. On that same date the trustee company resolved that the family trust distribute $90,000 of its income for the year ended 30 June 1980 to the accountant's trust (unnumbered). This distribution was effected to the No.80 trust on that date by a bill of exchange. This bill was endorsed on the back through a series of holders and returned eventually as a loan to the trustee company. No money changed hands.

9. On 1 July 1980 letters were signed by the husband and wife addressed to the trustee company purporting to exclude themselves as beneficiaries under the family trust deed from the date of the letter. On that same date a resolution by the trustee company was passed purporting to vary clause 2 of the deed by removing the husband and wife as beneficiaries and leaving the child and the accountant's unnumbered trust as sole beneficiaries. A deed of variation to this effect was executed on that same date pursuant to clause 7 of the deed.

10. For the year ended 30 June 1981 a similar series of manoeuvres was adopted. The amount in this year was $150,000 and the No.81 trust received the distribution via a bill of exchange. Eventually, after a series of endorsements on the back, this bill of exchange was returned to the trustee company in the form of a loan from No.91 trust. No actual money changed hands.

TRIBUNAL'S DECISION

11. The tribunal held that the arrangement was ineffective and dismissed the taxpayers' objections against their assessments for the years involved. In particular, it made the following findings.

12. Section 260 of the Income Tax Assessment Act applied. The Tribunal relied on the Federal Court decision in Oakey Abattoir Pty Ltd v FC of T 84 ATC 4718 15 ATR 1059, to render void as against the Commissioner the purported distributions of income from the family trust, the variations of trust, the resolutions therefor and the bills of exchange for the years ended 30 June 1980 and 1981.

13. In relation to the Commissioner's argument that the transactions were a sham the Tribunal considered that there was

doubt whether any party to the transactions intended them to have any legal effect other than tax minimisation. It concluded that, insofar as it was necessary for them to prove the transactions were genuine, the taxpayers failed on the onus of proof.

14. The Tribunal also found that the rule against perpetuities had been breached. Because the vesting date of the family trust deed depended in part on the date of death of the last survivor of the descendants of his late Majesty King George VI living at 4 June 1979, similarity of terminology together with a different date of execution led to the conclusion that any appointment in favour of the accountant's trusts and in particular his trust No.80, was for an excessive period and this offended the rule against perpetuities. The Tribunal took the same view with respect to the appointment and deed of variation dated 1 July 1980 in relation to the year of income ended 30 June 1981. The effect of these breaches was that each of the appointments in favour of the accountant's trusts (unnumbered) failed for remoteness.

15. The Tribunal also considered the validity of two clauses contained in the family trust deed. As to the power of appointmnt under clause 7, they adopted Lord Wilberforce's view expressed in McPhail v Doulton (1971) AC 424 at 457 that the objects of a trust power should form a class which is not so large or arbitrary that it cannot be said for certain that a particular person was within the settlor's contemplation as an object of his bounty. The Tribunal considered that there should be some certainty as to the class of appointees going beyond exclusion of the settlor and the trustee. Clause 7, insofar as it purported to extend to any person, appeared to create the greatest uncertainty and to achieve by the use of trusts and powers what is impossible to achieve by means of a testamentary disposition. The Tribunal held this clause to be ineffective but regarded clause 2 in its original form as effective.

16. Looked at from another viewpoint, the Tribunal held that it amounted to a fraud on the power of appointment for the family trustee company to exercise such power not for any discernible purpose of the settlement but for the purpose of minimising the tax of beneficiaries under the settlement by diverting income to an accountant's trust. To exercise the power to vary the trusts, given by clause 7 to appoint a different trust as beneficiary, was not only to appoint a new trustee of part of the income, but to provide for the money to be held expressly on the trusts of a different settlor. This trust was not subject to the same exclusions from benefit as the family trust. It would have been possible by a variation of trust for the trustee of the accountant's trust to return income to the settlor and the trustee of the family trust. The Tribunal held that the variations to introduce the number 80 & 81 trusts as beneficiaries under the family trust were invalid.

17. As to the disclaimers dated 1 July 1980 seeking to exclude the husband and his wife from their income entitlement for the year ended 30 June 1980, the Tribunal held them to be

ineffective. The taxpayer husband and wife had been entitled to income ever since the inception of the family trust. The Tribunal stated that for disclaimers to be effective they should occur within a reasonable time. This was not the case in this instance.

18. Finally, the Tribunal refused to remit any further the penalties imposed by the Commissioner.

RULING 19. The decision of the Tribunal confirms the Commissioner's firmly held views that this form of tax avoidance scheme is ineffective. However, the decision is subject to appeal. In accordance with Taxation Ruling No. IT 2102, trust stripping schemes entered after 27 May 1981, the date of effect of Part IVA of the Act, are assessed on the same general basis except that Part IVA rather than section 260 may apply.

COMMISSIONER OF TAXATION
21 January 1988