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Let's chat

30 June Compliance Roundup – June 2021

With:

Darius Hii – Tax and estate planning lawyer; Chartered Tax Advisor; and Director at Chat Legal

Information provided is general in nature; precise application depends on specific circumstances



Topics

- When journal entries don't constitute loan repayments
- Trust distributions and the 'anti-avoidance' provisions
- Backdating
- Retro-witnessing



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Repaying loans by journal entry

Journal entry alone not sufficient



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- Journal entries cannot create or constitute a transaction in its own right.
- Only record a transaction that has already occurred, so legal requirements must be met in order to be effective.
- Contemporaneous evidence is also required as the backdating of documents are not effective.
- In the ideal world – cash payment made to company.
- In practice – company profit used to pay dividend by journal in satisfaction of minimum yearly repayment obligation owed by the shareholder



Principal of mutual set-off

- Journal can only constitute a payment where the *principle of mutual set-off* applies.
- Requires two parties who mutually owe each other an obligation agreeing to set-off their liabilities against each other.
- In relation to mutual set-offs from a fringe benefit perspective:
Journal entries...only amount to a payment of an employee's contribution towards a fringe benefit if the employer and employee have agreed to set-off the employee's obligation to make the contribution (where such an obligation exists) against any obligation of the employer (such as an agreed obligation of the employer to lend money to the employee) to the employee.... In setting-off the liabilities it is not necessary to go through the formality of handing the money backwards and forwards. – Paragraph 6 MT 2020
- Cannot be applied, however, if no cross-liabilities exist between parties.



Principal of mutual set-off

- Mutual set-off available between company and shareholder as:
 - Division 7A loan owed by shareholder to company
 - Dividend owed by company to shareholder
- Not available where loan is with an associate of the shareholder, unless a liability can exist.
- Also requires a dividend to be validly declared by 30 June.
- Should a formal document exist to evidence set-off(?)



Corporations Act

- Section 254T *Corporations Act 2001* (Cth)
A company must not pay a dividend unless:
 - (a) *The company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend; and*
 - (b) *The payment of the dividend is fair and reasonable to the company's shareholders as a whole; and*
 - (c) *The payment of the dividend does not materially prejudice the company's ability to pay its creditors.*
- Ability to declare dividends governed by company governing rules
- Need to have appropriate minutes/resolutions which are to be kept with the company rules



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Trust distributions and 'anti-avoidance'



Our position

- You can use discretionary trusts to distribute to family members if:
 - You actually give such distributions to those family members;
 - Those family members confirm their agreement to allowing the trust to use unpaid distributions for future investment;
 - There is a general ordinary family dealing where family members pool their funds together.
- If naming family members as beneficiaries without distributing such amounts or allowing them to be included into the pool of benefits of the family group – then beware the application of section 100A.
- More simply, only distribute to family members if you are comfortable to allow those family members to call upon any unpaid amounts.



Section 100A

- Ongoing ATO audits in relation to 100A
- Expected continued focus in a drive to alter the operation of trusts (with no legal support)
- Standard templates used which includes plan to formally record interviews of family members (under oath) by ATO counsel.
- Contracted reviews and continued delay of the ATO issuing 100A guidance



Section 100A – good compliance

- Rigorous documentation on how beneficiaries are aware of and direct the use of their trust entitlements.
- Rigorous review of ensuring compliant trust resolutions prepared.
- Each beneficiary should be advised in writing of their trust entitlement.
- Each beneficiary should acknowledge in writing their ability to demand their entitlement in cash.
- Beneficiaries should authorise application of unpaid present entitlements for trust use as a unilateral act.
- Trustees should accept potential for unilateral demand on unpaid present entitlement.
- Trustees should confirm distribution decision is not related to any services the beneficiary may have provided/will provide to any party (e.g. to a family business) – but only flows from their status as a beneficiary.
- Evidence of ordinary family dealings (?)



Part IVA

- Whenever asking 'how can we pay less tax' – Part IVA must be a consideration.
- Recent changes to Part IVA eliminates the 'do nothing' defence.
 - Could lead ATO arguing distributions would be made to high-paying individuals.
 - *'...and would never have distributed such a substantial portion to either my wife or I' – McCutcheon v FCT [2008] FCA 318*
- Documenting foundation facts, which can also include evidencing trust loans and characterising bank transfers accordingly.



Part IVA – Foundation of facts

- Working up trust distribution resolutions?
- Include reasoning behind a distribution, such as for asset protection reasons?
- Formal documents between related parties.
- Legal analysis of alternatives to the scheme?
- Supporting bank transactions or use of financial instruments to evidence payments.
- Should the trustee be doing the above anyways as part of their fiduciary duties?



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Backdating



History cannot be rewritten

- *David v FCT* [2000] FCA 44

“The parties to an agreement cannot effect a change to an agreement retrospectively so that the agreement between them is altered as against the rest of the world. The parties can, no doubt, enter into an agreement, binding as between them, that a prior agreement they have entered into will be construed in a particular way from the moment the prior agreement was entered into. But the original agreement will, so far as the Commissioner is concerned, govern their relationship until the time of its amendment. For example A and B may enter into an agreement which provides, inter alia, that certain income will, for the term of the agreement, be held by A in trust for B. Later the parties may as between them agree to alter the arrangement ab initio to provide that that income will not be held in trust for B, but will always be treated as belonging to A beneficially. The agreement will be binding inter partes, but for income tax purposes the income will, until the date of the agreement, still be treated as beneficially the income of B.”



Mistake \neq rewriting

- Distinguished from circumstances arising from mutual mistake which can be rectified (quote from prior case):

As an alternative to an order of rectification the parties could execute a deed rectifying their prior writing. That deed, if truly operating to record that the parties were under a mutual mistake, and also setting out what the parties acknowledge to be the true agreement between them would not, any more than a court order, actually alter the position as between the parties. It would merely record that agreement as it always was. Whether by court order or by deed, rectification requires that there be a mutual mistake, that is to say what is required is that there be a common intention between the parties as to the effect that the instrument they signed would have had which was inconsistent with the effect which the instrument which they executed in fact had: cf Commissioner of Stamp Duties (NSW) v Carlenka Pty Ltd (1995) 95 ATC 4620. Mistake as to the revenue consequences of the agreement would not bring about the same result: Baird v BCE Holdings Pty Ltd (1996) 40 NSWLR 374 at 384.”



Dating

- Note distinction between date of document and effective date of transaction
- Regarding the date of document:
“It is unnecessary to discuss the evidence with respect to the date on which the agreement was signed at any length. The document bears date 13th September 1939, and, in the absence of any proof to the contrary, there would be a presumption that it was executed on that date (Anderson v. Weston [1840] EngR 375).”
- Where evidence exists to the contrary of the date of the document?



Consequences of backdating

- Code of Professional Conduct
- Penalties where making a statement that is false or misleading
- Litigation (as between beneficiaries of a discretionary trust)
- Failed trust distributions



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Retro-witnessing



Lewis v Lewis [2020] NSWSC 1306

- Son prepared Will on behalf of mother.
- Asked neighbours to witness (as son could not witness).
- Mother signed Will first and was sleeping by the time neighbours came over.
- Son told neighbours mother signed the Will and gone to be and said “This is not the right way to witness the will but I will have to deal with it at a later stage. Do you mind signing anyways?”
- Original Will not found, so photocopy of Will provided in evidence and disputes as to effectiveness of certain Wills
- Court found actions of Son to be discreditable



Lawyer falsely witnessing

- Solicitor who falsely claimed witness to signature reprimanded - Lawyers Weekly
 - Solicitor falsely witnessed enduring power of attorney document
 - Had not met or known principal at time of 'witnessing'
 - Also failed to explain enduring power of attorney document
- Solicitor reprimanded for falsely signing document amid workplace stress - Lawyers Weekly
 - Solicitor falsely signed and had a colleague witness a non-work-related document
 - Related to an Australian passport application that the solicitor signed with ex-husband's signature and asked colleague to falsely witness it
 - Found out when agency phones ex-husband in relation to passport application

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