Removal of CGT Trust Cloning Exemption

The government has announced that it is going to enact legislation to remove the application of the capital gains tax "trust cloning exemption" to CGT events E1 and E2. The removal of the exemption applies from Friday 31 October 2008. Corporate lawyer, Adrian Cartland explains the implications.

The trust cloning exemption, contained in sections 104-55(b) and 104-60(b) of the Income Tax Assessment Act 1997 (Cth), provides an exemption from capital gains tax where an asset is transferred from one trust to another trust and the "beneficiaries and terms of both trusts are the same".

A "cloned trust" is a trust that is created which has the same terms and beneficiaries as another trust (the "original trust"). Assets are transferred from the original trust to the cloned trust, and if the cloning is successful, i.e. the beneficiaries and terms of both trusts are the same, then no capital gains tax liability will arise.

Trust cloning is particularly useful in succession planning where discretionary trusts, such as family trusts, are involved.

For example, a couple controls a discretionary trust which is established for the benefit of their two adult children, their lineal descendants and any entities associated with these. If the couple passed away and left the control of the discretionary trust to the two children there is the possibility of dispute over how the assets of the trust are managed, invested etc. and how any income or capital is distributed.

However if the couple create a clone of the original trust and transferred, say, half the assets of the original trust to the cloned trust, then a separate trust would be able to be left to each child. Each child would be able to deal with the assets of their individual trust in the manner that they see fit, thus eliminating this potential dispute.

Problems with trust cloning

Problems can arise when the terms of the original trust and the cloned trust are not the "same". While it may seem that simply putting the original trust deed through the photocopier may create an identical trust, this is not the case for most family trusts. A simple example serves to illustrate the point. The original trust has a vesting date (i.e. the date on which the trust must be wound up upon) which is 80 years in the future from the date that the trust was created. If the trust deed were copied exactly, and the cloned trust was created 10 years after the original trust, then the cloned trust would have a vesting date which is 10 years later than the original trust. The terms of the two trusts would not be the same and there would be no capital gains tax exemption for assets transferred between the two trusts.

The trust cloning exemption was in fact not originally intended in the drafting of sections 104-55(b) and 104-60(b). The exemption was intended to apply where a trust merely changes its trustees. The Tax Office later accepted that the exemption applied to cloning trusts on a plain reading of the legislation (see Taxation Determination TD 2004/14), but tried to limit the exemption in Taxation Ruling TR 2006/4 by taking a restrictive view of the requirements to effectively establish a trust which is the "same" as the original trust.

After becoming aware of numerous instances where "cloned" trusts, particularly discretionary trusts, were not exactly the "same" as the original trust, the Tax Office adopted a stricter view of the requirements to access the exemption, as stated in its announcement of 30 January 2008. It is therefore not entirely unexpected that the government has now moved to abolish the application of the exemption for changing trustees to trust cloning.

The future

The other current exception to CGT events E1 and E2, where the taxpayer is the sole beneficiary of the relevant trust that is not a unit trust and the taxpayer is absolutely entitled to the asset as against the trustee, will be retained. Also, a mere change of trustee of a single trust will continue not to trigger a CGT liability.

Although the legislation has not been drafted yet, it appears from the government announcement that the denial of an exemption for trust cloning will not apply retrospectively.

The removal of the opportunity to clone trusts without incurring a capital gains tax liability closes off a much debated succession planning tool. It remains to be seen what will be used in its place.

Personal Property Securities Law Reform Update: Content for Personal Properties Securities legislation released

The Australian Attorney-General has released the revised draft of the Personal Property Securities Bill 2008 which includes changes made in response to the stakeholder submissions on the consultation draft of the Bill (released 16 May 2008). Corporate partner, Craig Wappett and lawyer, Alison Blyth discuss the revised draft.

The draft Bill, referred to as the Exposure Draft of the Bill, has been referred to the Senate Standing Committee on Legal and Constitutional Affairs and it is expected they will provide their recommendations on the Exposure Draft by 24 February 2009.

The Bill is proposed to be enacted in the first half of 2009 for commencement in May 2010, along with the Personal Property Securities Register.

The proposed personal property securities legislation and register are intended to replace the myriad of existing Commonwealth, State and Territory laws and registers for company charges, bills of sale, motor vehicle securities, crop liens, stock mortgages and most other securities affecting tangible and intangible personal property rights.

The reforms will not only rationalise the number of laws and registers governing personal property securities, they will also introduce substantive changes to the law of particular importance to creditors, equipment lessors, consignors and other retention of title suppliers, purchasers of accounts receivable and insolvency practitioners.

With limited exclusions, the legislation will apply to all security interests in tangible and intangible personal property. Personal property is any kind of property other than land, fixtures or a right, entitlement or authority that is granted by a Commonwealth, State or Territory law and declared by that law not to be personal property for the purposes of the personal property securities legislation.

The changes made to the Exposure Draft of the Bill in response to the stakeholder submissions affect:

- key concepts including: inventory, knowledge, licences and the definition of PPS leases
- references to fixed and floating charges in other legislation
- investment instruments and investment entitlements
- control of ADI accounts
- transfer and assignment of rights in collateral
- principles of attachment and future advances
- priority of purchase money security interests
- agricultural products, accessions and commingling
- enforcement
- the operation of Personal Property Securities Register
- void transactions
- standard time, i.e. the legal time applying in the Australian Capital Territory will be the standard time for the purposes of the Bill
- transitional provisions.

The release of the Exposure Draft and its referral to the Senate Standing Committee on Legal and Constitutional Affairs shows the government is well on track to enact this legislation in the first half of 2009.

Those business which will be affected by the legislation should make themselves familiar with the draft legislation and their own systems and necessary changes now, to ensure they are ready.

ACCC v ANZ: round one to the bank

Dispute resolution partner, Tom Griffith explores the recent decision of the Federal Court in which the ACCC has recently had its Statement of Claim alleging anti-competitive conduct within a market against the ANZ Bank struck out.

The ACCC had commenced proceedings against the Bank alleging that the Bank had engaged in conduct in breach of sections 45 (2) (a) (ii) and 45 (2) (b) (ii) of the Trade Practices Act 1974 (the Act), the prohibition against companies entering into or giving effect to contracts, arrangements or understandings that have the purpose or effect of substantially lessening competition.

One of the Bank's main complaints about the Statement of Claim was that it failed to identify the material facts upon which the ACCC relied, such that the pleading had the tendency to cause prejudice or embarrassment to the Bank.

The Federal Court identified that the Commission, in bringing a claim under sections 45(2) and 45A of the Act needed to:

in respect of s 45(2):

ě plead material facts that establish the making of a contract or an arrangement or an understanding arrived at between the relevant participants

ě isolate a provision of that contract, arrangement or understanding which is said to have the purpose or be likely to have the effect required by the Act

ě isolate material facts from which an inference of purpose might be drawn or facts from which the contended effect might be established

ě plead material facts that establish the relevant market in which competition would be lessened and the circumstances of the lessening

and in respect of s45A:

ě isolate a provision of the contract, arrangement or understanding which has the purpose or has or is likely to have the effect of fixing, controlling or maintaining, or providing for the fixing, controlling or maintaining of, the price for, or a discount, allowance, rebate or credit in relation to particular services

ě plead material facts identifying the particular services either supplied or acquired or to be supplied or acquired by the parties to the contract, arrangement or understanding or by any of them (or related entities) and material facts which establish that the parties to the contract, arrangement or understanding engaged in the supply or acquisition of the relevant services are in competition with each other in relation to those services.

The Court concluded that the ACCC's pleading as presently drafted did not satisfy the above requirements, and was struck out.

The decision shows the rigour that the Courts will apply to alleged breaches of these sections of the Act.


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Lumbers v W Cook Builders: The High Court's latest word on restitution

Dispute Resolution law clerk Sebastian Hartford-Davis discusses the recent High Court decision which deals with important issues of restitution and unjust enrichment and provides some useful reminders about best practice in commercial contracts.

The Lumbers were building a 'quite distinctive' house in North Haven, near Adelaide, which ultimately cost more than $1 million to build.

They concluded an oral agreement with W Cook & Sons Pty Ltd ('Sons') to build the house. Most of the work, however, was done by a related company, W Cook Builders Pty Ltd ('Builders'). Moneys were paid by the Lumbers to Sons and then, unbeknownst to Lumbers, passed on to Builders.

The proceedings arose out of a claim by Builders (in liquidation) to recover $261,715 which was said to be owing by Lumbers to various subcontractors and as a fee for supervision owing to Builders.

Lumbers disputed the amount. Negotiations and payments had always been made between Lumbers and Mr McAdam, who was the controlling mind of Sons. Sons had previously informed the Lumbers that no money was owing between Lumbers and Sons and accordingly Lumbers denied any obligation to Builders.

Decisional history

The trial judge (Justice Beazley of the SA Supreme Court) held that there was no contract between Builders and Lumbers. The Judge found:

- Firstly, that Lumbers reposed a significant degree of personal confidence in Sons and identified Mr McAdam as the person they wished to deal with. There was evidence that they would not have consented to the sub-contracting of the work to Builders, notwithstanding that Builders was a related company.
- Secondly, that there was no intention on the part of Sons to assign the benefit of the building contract to Builders. Thus Builders was, at law, a sub-contractor.

Builders also framed a claim in terms of restitution for unjust enrichment, since Lumbers was obtaining the benefit of paying $260,000 less than they otherwise would have paid for the house, to the detriment of Builders. The claim in restitution was dismissed by the trial judge because it was inconsistent with the nature of the agreement between Sons and Lumbers.

The Full Court of the Supreme Court of SA upheld the appeal by majority, on the grounds of the restitution argument. The majority deliberately ignored the agreement between Sons and Lumbers, and concentrated instead upon an analogy between the case and the High Court's decision in Pavey & Matthews Pty Ltd v Paul and relied on this case, which was a quantum meruit claim brought by a builder against the owner, to enforce (by restitution) an oral contract which was unenforceable because of statute. On this basis, the majority upheld the appeal on the traditional unjust enrichment elements; since there was an enrichment of the Lumbers, at the detriment of Builders, which would be unconscionable to retain.

The High Court restored the finding of the Trial Judge. It did so because of the inconsistency between the facts of the case, and the facts in Pavey & Matthews v Paul. The case was inconsistent because of the nature of the relationship between the Lumbers and Sons. The Court said (at paragraph [45]):

'in considering Builders' restitutionary claim, the contractual relations between the Lumbers and Sons, and between Sons and Builders, cannot be put to one side as an inconvenient distraction.'

Further, the High Court criticised the failure of the Full Court to analyse the legal effect of certain facts, the failure to analyse the existence of a claim by Builders against Sons and the failure to call certain interested parties to give evidence.

Legal significance

Though it is not mentioned in the judgment, this case follows in logical sequence from the Court's decision in Farah Constructions Pty Ltd v Say-Dee Pty Ltd, handed down in May 2007:

- There, it was reaffirmed as a matter of law that 'unjust enrichment' is a unifying principle rather than an underlying cause of action. The Court emphasised there that unjust enrichment could not be used in order to circumvent deficiencies in other established causes of action (in that case the two limbs of Barns v Addy, that is, 'recipient liability' and 'assistance-based liability' for breach of a constructive trust).

- This case emphasised, by implication, the inability of 'unjust enrichment' and restitution to circumvent factual deficiencies in a plaintiff's argument.

The Court said that attempts to extend the scope of restitutionary claims 'beyond the bounds set by legal principle' should be discouraged, 'especially where to do so would be to cut across or disturb contractual relationship and established allocation of risk.'

The case also emphasises the importance of adducing proper evidence in contractual litigation. In particular, where an oral contract is concerned, all relevant parties to the contract should be called.

Broader significance

More broadly, this case illustrates the pit falls of negotiating a contract orally and without written evidence. This is true both for the owners of property and for the builders. The differing decisional history illustrates how the case could easily have gone either way, but for the existence of certain evidence.

In this case, much turned on the insistence by the Lumbers that it was Mr McAdam with whom they were entrusting management of the project. The conduct and actions in negotiating a contract can have extremely significant legal effect, particularly where the contract is oral and not subject to the parol evidence rule (that extrinsic evidence is not to be used to construe a complete, written agreement).

The difficulties inherent in the company structure adopted by Sons and Builders should be noted, whereby:

- negotiations are conducted and money received by one company

- loss is incurred and work carried out by another company.

The law views a service contract differently to a contract for the sale of goods (for example). This is particularly so where the contract is conducted with someone who (like Mr McAdam) had a reputation which was important to the Owner. Where service contracts are involved, then, one needs to be alive to the difficulties involved with complex company structures.