TAX TALKS

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The Guardian case will give you a better defence when accused of a so-called ‘washing machine arrangement’.

The Guardian Case

In the *Guardian* case, the ATO lost on three counts when claiming that Guardian was a washing machine arrangement. That is a big loss.

In this episode, Andrew Henshaw of Velocity Legal in Melbourne will walk you through the details of this case. Here is what we learned but please listen in Andrew explains all this much better than we ever could.

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The Guardian Case

The *Guardian* case – *Guardian AIT Pty Ltd atf Australian Investment Trust v Commissioner of Taxation [2021] FCA 1619* – was heard on 20 to 22 April 2021. Date of judgment was 21 December 2021.

In this case, the ATO lost on three counts in a single judge decision. The taxpayer only needed to win one point to win the case. And they won three.

However, the case is on appeal at the moment. But remember that it has to be a question of law. The Federal Court can’t decide on a question of fact.

Turning Rental Income into a Franked Dividend

The Guardian case included a discretionary trust which had a number of income sources, including rental income. Then there is a controller of the group who is a non-resident and a resident of Vanuatu. And then there also was a bucket company.

The trust streamed the dividend to the individual and the rest to the company. So the rental income went to the bucket company. The next year the bucket company declared a dividend back to the trust. And then the trust distributed the income to the individual as a dividend.

The result is that the rental income is now a franked dividend that is not subject to withholding tax since franked. And so only 30% tax is paid on the income and not 47% foreign resident tax rates. They did this for three years.

The ATO didn’t like this. And so they issued assessments as well as amended assessments plus 50% penalty. The taxpayer objected and they went to court.

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Three Points the ATO Lost

Here are the three elements the ATO lost in the Guardian Case.

1 – No Reimbursement Agreement at Time of Distribution

The Court accepted that there was no agreement at the time of distributions. Even though the distributions happened three times. Even though there was a reimbursement agreement. It wasn't there at the time of distribution. The reimbursement agreement needs to exist before a present entitlement is confirmed.

2 – No Tax Reduction Purpose

In order for s100A to apply the purpose of the agreement must be a reduction of income tax. The purpose of the agreement must be to reduce somebody's income tax. What the court says is that this requires a hypothesis of what income tax would become payable if the reimbursement agreement had not been entered into. Who would have paid how much tax if this agreement had not been entered into?

In the Guardian case, the ATO argued that the distribution should have gone straight to the individual. The taxpayer argued that they would not have done that. They would have kept the income in the company for asset protection purposes. And so no tax was saved. The Court accepted that. And ruled that you can only look at the dividends and can't go back to the original trust distribution.

See Axa Asia Pacific Holding where the taxpayer won against Part IVA. and triggered changes in legislation for Part IV A.

3 – Ordinary Commercial or Family Dealings

If there is an ordinary commercial or family dealing, then it is excluded and s100A doesn't apply. The taxpayer claimed that it was a family dealing – worried about asset protection.

The Court said that you can't use the benefit of hindsight. And accepted that this was an ordinary commercial or family dealing.

So these are the three points the ATO lost. The Guardian case should give you a stronger defence when the ATO claims that you have entered into a so-called 'washing machine arrangement'.

MORE

s100A ITAA36

Default Beneficiary

Missing Trust Distributions

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