Trusts Inadvertently Grouping Family Businesses for Payroll Tax

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1 Introduction

1.1 Payroll tax – it is often referenced as a large deterrence against small to medium businesses from expanding and hiring additional staff.[1]

1.2 A Treasury Working Paper in 2018, however, concluded to the contrary that '*in general*[,] *there is little change in behaviour of firms around payroll tax thresholds*'[2].

1.3 Although the Treasury Working Paper acknowledged that this may be due to the structuring of arrangements, an alternative reason could be due to the lack of understanding or misunderstanding of the payroll tax legislation, including its application to businesses conducted by discretionary trusts.

1.4 This lack of understanding combined with an increase in data matching by Government bodies may inadvertently lead to businesses exceeding the applicable State or Territory (collectively, the **States**) payroll tax tax-free threshold.[3]

1.5 This paper seeks to shed light on the 'grouping' provisions contained in the payroll tax legislation and how such provisions, particularly those applying to discretionary trusts, may result in two or more businesses, whose taxable wages individually would not exceed the payroll tax tax-free threshold but combined would exceed the payroll tax-free threshold and result in a payroll tax liability owed by both businesses.[4]

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[1] https://www.abc.net.au/news/2018-08-30/drought-bites-big-businesses-and-apprenticeships-dry-up/10179636; https://www.afr.com/news/policy/tax/pauline-hanson-wants-payroll-tax-gone-20180226-h0wnae

[2] B Ralston, "Does payroll tax affect firm behaviour", 2018 Treasury Working Paper, page 19.

[3] For example, Queensland has a payroll tax tax-free threshold of $1.1 million. This means that an entity conducting a business can pay up to $1.1 million in taxable wages to certain workers without being liable to pay payroll tax. Once wages exceed $1.1 million, payroll tax will be payable on the wages equal to 4.75%. 'Deductions' are available to reduce the total taxable value of the wages subject to payroll tax until wages exceed $5.5 million

[4] For example, business 1 pays $800,000 in taxable wages per annum (in Queensland). No payroll tax liability would arise as the taxable wages of business 1 does not exceed the $1.1 million threshold. If, however, business 1 is grouped with a second business paying $500,000 in taxable wages per annum (in Queensland), then the total taxable wages of both businesses would exceed the tax-free threshold of $1.1 million and the businesses would be liable for payroll tax

1.6 Specifically, this paper looks to provide examples and cases on how the inclusion of a discretionary trust (whether as a business entity or a passive investment entity) may inadvertently result in businesses being conducted by different family members or beneficiaries being grouped. Some available solutions will also be explored in managing this risk.

1.7 For the purposes of this paper, any reference to 'Payroll Tax Act' is a reference to the *Payroll Tax Act 1971* (Qld). As will be discussed below, the payroll tax legislation of each other States are largely identical regarding the grouping provisions, and therefore payroll tax cases from other States relating to the 'grouping' provisions will be referenced given the likely interpretation that can be adopted from the similarly worded legislation.

1.8 References to the payroll tax tax-free threshold will be a reference to the Queensland threshold of $1.1 million in taxable wages.

1.9 In contrast with payroll tax, any reference to stamp duty will be a reference to Queensland's *Stamp Duty Act 2001* (QLD), and specialist stamp duty advice should be sought if dealing with businesses in other States.

1.10 Finally, the focus of this paper relates to payroll tax. However, some suggested solutions will require consideration of the potential income tax and stamp duty consequences. Whilst a detailed analysis of the relevant law surrounding those taxes will be required, this paper will seek to provide a brief overview of some of the critical issues that must be considered.

2 Payroll tax – historical importance

2.1 To appreciate the rationale behind the grouping provisions and the complexities that arise today when it is applied to structures involving trusts, it is important to understand some of the key historical changes to the tax.

2.2 During World War II, key changes were made to Australia's tax system including:

(a) the introduction of a Commonwealth payroll tax, by way of the *Pay-Roll Tax Assessment Act 1941* (Cth), as a war-time measure to finance a national scheme for child endowment; and

(b) the Commonwealth government increasing its income taxation to meet the costs of the war effort – meaning disparities between taxpayers in different States given that the States also imposed income tax on its residents.

2.3 Having regard to the social and economic climate of the time, the purpose of the tax and what was then a relatively low rate of 2.5%, the initial payroll tax was not a significant concern for businesses.

2.4 To address the concern of disparities in the level of income tax paid by residents of each State, uniform tax arrangements were agreed upon between the Commonwealth and State governments, which were meant to apply for the duration of the War and one year after.[5]

2.5 After the War, this agreement was not honoured and the Commonwealth government continued to impose income tax despite its agreement with the States. In 1971 to resolve concerns over State versus Commonwealth income tax, the Commonwealth handed the administration and governing of payroll tax to the States (in return for sole administration of income tax), which resulted in an immediate increase in the payroll tax rate. In conjunction with the high inflation levels seen in the 1970s, payroll tax became a tax that clients and advisors looked at in various ways to manage exposure to.

2.6 One strategy was to split businesses into multiple entities, with each entity claiming a separate tax-free threshold (as the payroll tax legislation that was passed from the Commonwealth provided **each** employer a separate tax-free threshold).

2.7 As a result, the States (commencing with Victoria in 1974) sought to introduce grouping provisions as anti-avoidance measures to remove this ability for businesses to segregate their taxable wages into various separate entities.[6]

2.8 This intent behind the grouping provisions was acknowledged in the Explanatory Memorandum to the Pay-roll Tax (Harmonisation) Amendment Bill 2008:

> *"Grouping prevents employers avoiding pay-roll tax by splitting pay-roll over several entities, with each entity claiming the $1 million threshold/deduction"*.[7]

2.9 The payroll tax legislation in various jurisdictions continued to be amended over time to address concerns as they arose – for instance the introduction of specific

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[5] *'A brief history of Australia's tax system'*, Reinhardt S and Steel L., Australian Government Treasury

[6] Articles providing a detailed summary of the rationale from cases and second reading speeches around that time are as follows: D Marks, "Payroll tax de-grouping", (2012) Vol 15(3) *The Tax Specialist*, 127-135; G Matthew and S Batrouney, "The pay-roll tax grouping provisions – their purposes and application", Taxation Institute of Australia, Second Annual States' Taxation Conference 2002

[7] Explanatory Memorandum to the Pay-roll Tax (Harmonisation) Amendment Bill 2008, page 11 under the heading "Grouping"

contractor provisions to ensure the revenue base was not eroded by businesses electing to use contractors instead of employees, making it difficult to readily ascertain if payroll tax applied to payments for workers.

2.10 By the early 2000s, the payroll tax legislation in each jurisdiction, despite being similar, had its own idiosyncrasies. Businesses employing in multiple jurisdictions faced complexity in making sure they understood and complied with the specific requirements in each jurisdiction. To address this disparity, the Commissioners of all States committed in 2007 and again in 2010[8] to harmonise the practice of payroll tax to reduce discrepancies in how legislation is applied across the States. This was assisted through the harmonisation of the majority of each State's payroll tax legislation[9] and seven of the States agreeing to use jointly issued revenue rulings.

3 Grouping provisions

3.1 In Queensland, Division 2, Part 4 of the Payroll Tax Act groups employers where:

(a) they are related body corporates (**Grouping of Corporations**);

(b) there are common employees (**Common Employees**);

(c) one or more persons have a controlling interest in the employers (**Common Controllers**);

(d) an entity has a controlling interest in a corporation (**Tracing of Interests**); or

(e) an employer is a member of two or more groups (in which case both groups are combined) (**Common Group Member**).

3.2 Structures involving discretionary trusts are most likely to be grouped due to Common Controllers, but given only one of the five heads of grouping needs to be satisfied, it is important that businesses and their advisors understand the context in which the other grouping provisions may be triggered. For instance, there would be little point in ensuring a discretionary trust does not trigger the Common Controllers provisions if the relevant businesses were using the same employees (for instance a common book-keeper), thereby triggering grouping on the basis of Common Employees.

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[8] A Protocol for Payroll Tax Harmonisation between Jurisdictions dated 28 July 2010

[9] *Payroll Tax Bill 2007* (VIC); *Payroll Tax Bill 2007* (NSW); *Pay-roll Tax (Harmonisation) Amendment Bill 2008* (QLD); *Pay-roll Tax (Harmonisation Project) Amendment Act 2008* (SA); *Pay-roll Tax Assessment Amendment Bill 2010* (WA); *Pay-roll Tax Amendment (Harmonisation Act) 2008* (NT); *Payroll Tax Act 2008* (TAS); *Payroll Tax Bill 2011* (ACT)

3.3 On this basis, each grouping ground will be considered in more detail below before considering the practical impact for discretionary trusts and the ramifications when entities are grouped for payroll tax purposes.

3.4 Diagrammatic examples will also be provided throughout this section.

Grouping of Corporations

3.5 Section 69 Payroll Tax Act states that corporations constitute a group if they are related bodies corporate.

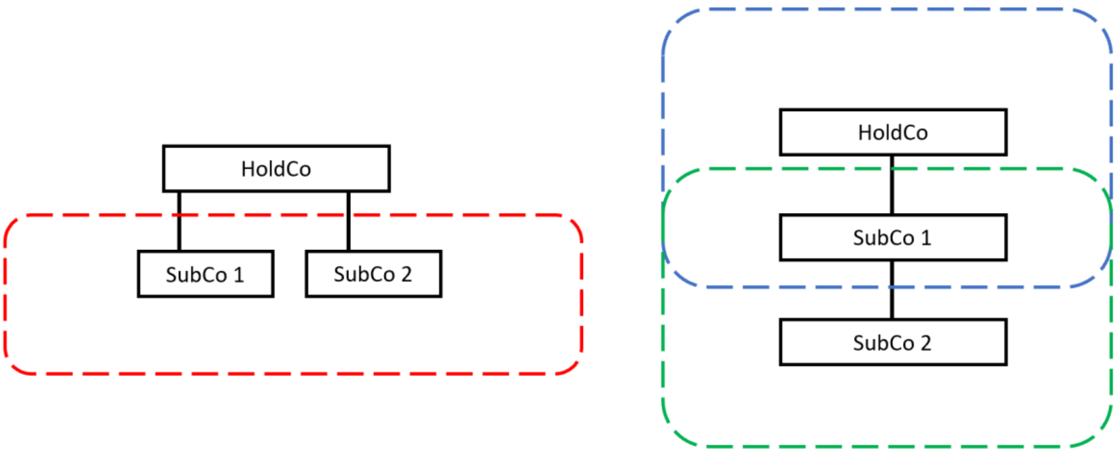
3.6 'Related body corporate' adopts the meaning in section 66 Payroll Tax Act[10] which references section 9 *Corporations Act 2001* (Cth) (**Corporations Act**).

3.7 Section 9 Corporations Act defines a 'related body corporate' as '*a body corporate that is related to the first-mentioned body by virtue of section 50* [of the Corporations Act]', being:

(a) a holding company of another body corporate;

(b) a subsidiary of another body corporate; or

(c) a subsidiary of a holding company of another body corporate.[11]



3.8 A company (**first body**) is a subsidiary of another if the other company (**holding company**):

(a) controls the composition of the first body's board;

[10] Definition of 'related body corporate' in the Schedule, *Payroll Tax Act 1971* (QLD)
[11] Section 50 *Corporations Act 2001* (Cth)

(b) can cast more than 50% of the votes at a general meeting of the first body; or

(c) holds more than 50% of the issued share capital in the first body; or

(d) if the first body is a subsidiary of a subsidiary of the holding company.[12]

3.9 As can be appreciated, data matching between various State revenue authorities and ASIC can allow for revenue authorities to easily identify when companies are grouped as related body corporates.

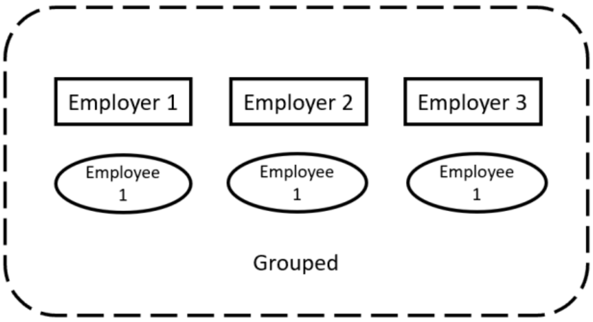
Common Employees

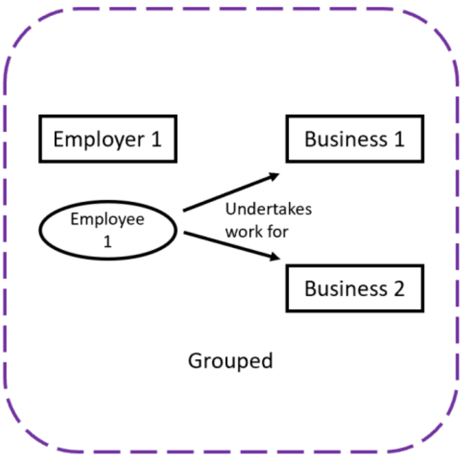
3.10 Section 70 Payroll Tax Act states that businesses can be grouped if:

(a) there is at least one mutual employee performing duties for one or more businesses – all businesses with the mutual employee are grouped;

(b) a person is employed by an entity (the **employer**) and that person performs duties solely or mainly for one or more other businesses – all business with the person carrying on work **as well as** the employer are grouped;

(c) a person employed by the employer performs duties with another business in connection with the employer's obligation to that other business under an agreement.





3.11 The ability for Common Employees to group businesses inadvertently should not be understated, and issues can arise in numerous common circumstances such as:

[12] Section 46 *Corporations Act 2001* (Cth)

(a) professionals who share staff (examples can include medical practitioners, barristers/lawyers, accountants, financial planners and real estate agents conducting their separate businesses from a common premises common administrators performing work for more than one business); and

(b) family businesses where family members or particular employees perform duties for more than one business – for instance book-keeping services.

3.12 Regarding the grouping of professional practices on the grounds of Common Employees, administrative guidance (based on case law) has been issued, confirming the Commissioner will exercise their discretion to de-group professional practices using a common 'administrative entity' if certain requirements are satisfied.[13]

3.13 In contrast with some of the other grouping grounds, it can be difficult for revenue authorities to identify grouping by Common Employees. That said, clients and advisors must be aware for the potential for their business to be grouped to ensure they can appropriately manage any risk.

Common Controllers

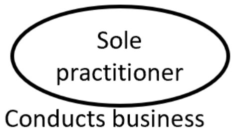
3.14 Structures involving discretionary trusts are most likely to be grouped under section 71 Payroll Tax Act, which outlines the various scenarios where if a person or set of persons have a controlling interest in two or more businesses, those businesses are deemed to constitute a group.

3.15 A person can be said to have a controlling interest in an entity conducting a business in any of the following circumstances:

Entity conducting business	***Who holds a controlling interest***

[13] Harmonised Revenue Public Ruling PTA 017 states that the Commissioner will exercise their discretion to exclude two or more professional practices with common employees from being grouped for payroll tax purposes if all of the following are met:

a) none of the persons who own or operate the professional practices has a proprietary interest, whether directly or indirectly, in any of the other professional practices;
b) the professional practices are carried on independently of, and are not connected with, each other (i.e. there is no significant financial interdependence and/or commercial transactions between the professional practices, and each professional practice is managed separately);
c) none of the persons who own or operate the professional practices has a controlling interest (as defined in ss.71 and 72 of the Payroll Tax Act), in their own right, in the administrative services business;
d) the administrative services business does not derive more than 60 per cent of its income from one professional practice; and
e) there is no suggestion that such a structure is designed to avoid payroll tax

<table>
<tr><td>Single person</td><td>That person</td></tr>
<tr><td colspan="2">
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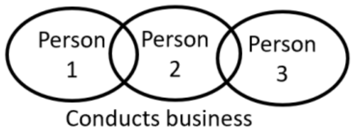
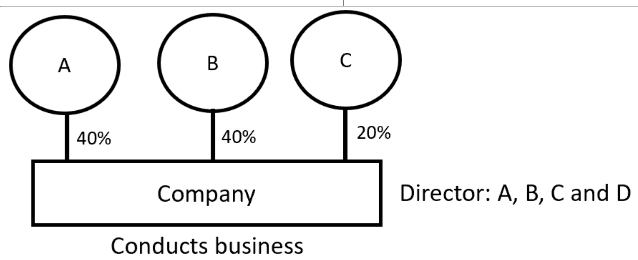
<tr><td>A set of persons</td><td>Collectively, the set of persons</td></tr>
<tr><td colspan="2">
</td></tr>
<tr><td>Corporation</td><td>The person or set of persons entitled to exercise more than 50% of the voting power at a meeting of directors</td></tr>
<tr><td>Body corporate or unincorporated</td><td>The person or set of persons who constitute more than 50% of, or control the composition of, the board of management</td></tr>
<tr><td>Corporation with a share capital</td><td>The person or set of persons who can directly or indirectly, exercise, control the exercise of, or substantially influence the exercise of, more than 50% of the voting power attached to the voting shares, or a class of voting shares, issued by the corporation</td></tr>
<tr><td colspan="2">
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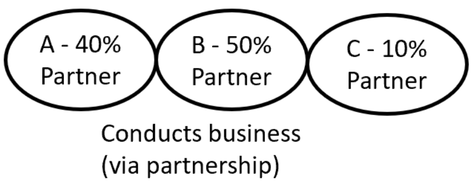
<tr><td>Partnership</td><td>The person or set of persons who either own (whether beneficially or not) more than 50% of the capital or are entitled to more than 50% of the profits of the partnership</td></tr>
<tr><td colspan="2">
</td></tr>
<tr><td>Trust</td><td>The person or set of persons, whether or not as the trustee or beneficiary of another trust, who is a</td></tr>
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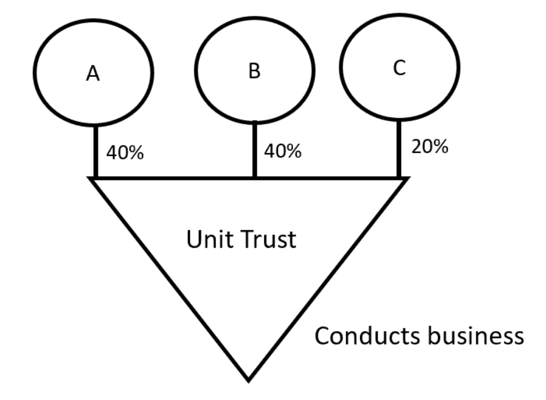
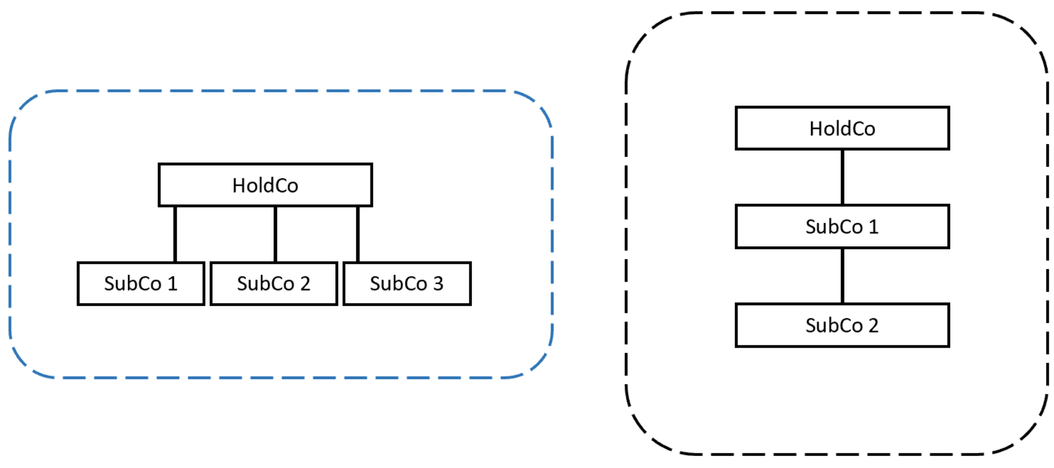
	beneficiary in respect of more than 50% of the value of the interests in the trust



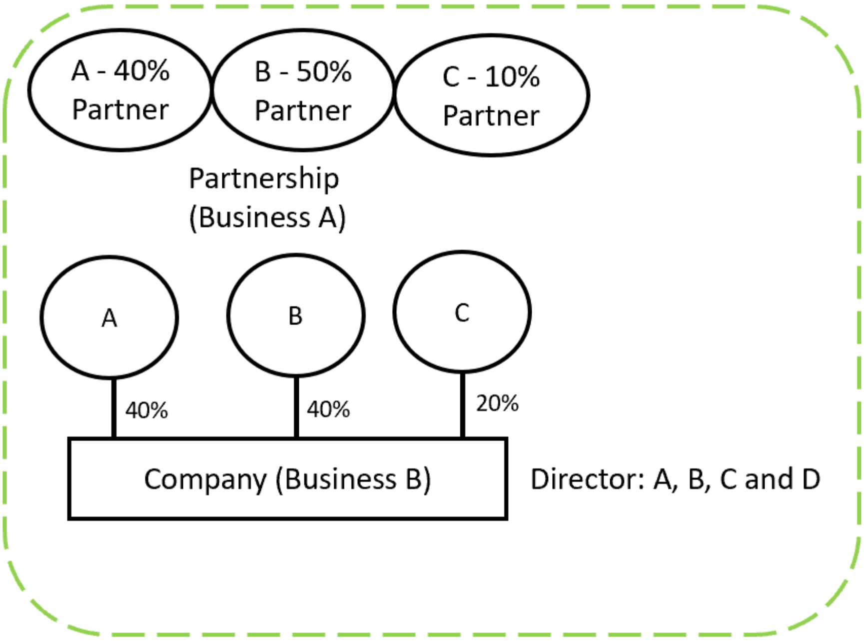
3.16 In addition to the general common ownership rules above, sections 71(3) to (8) Payroll Tax Act states additional deeming grouping provisions, namely:[14]

(a) section 71(3) Payroll Tax Act – If one related bodies corporate has a controlling interest in a business, then the other related bodies corporates are deemed to have a controlling interest in that business;

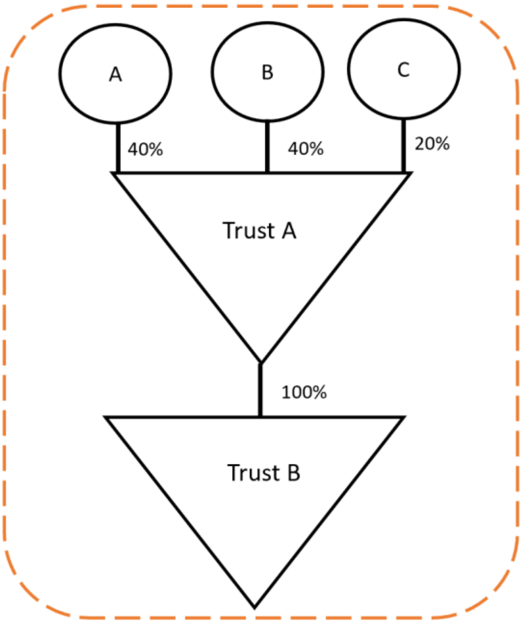


(b) section 71(4) Payroll Tax Act – If a group of persons (**Group A**) has a controlling interest in a business (**Business A**) and a group of persons carrying on that business (**Group A**) has a controlling interest in another business (**Business B**), then Group A is deemed to have a controlling interest in Business B;

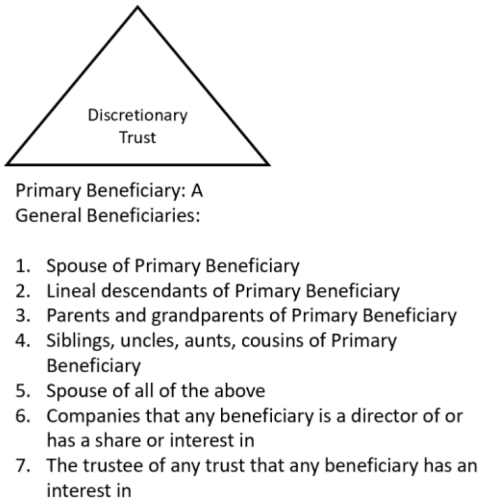
[14] Please note that defined terms in each subparagraph of this paragraph is limited to that subparagraph



(c) section 71(5) Payroll Tax Act – If a group of persons (**Group A**) have a beneficial interest in a trust (**Trust A**) of more than 50% and the trustee of Trust A (whether with someone else or not) has a controlling interest in the business of another trust (**Trust B**), then Group A is deemed to have a controlling interest in Trust B;

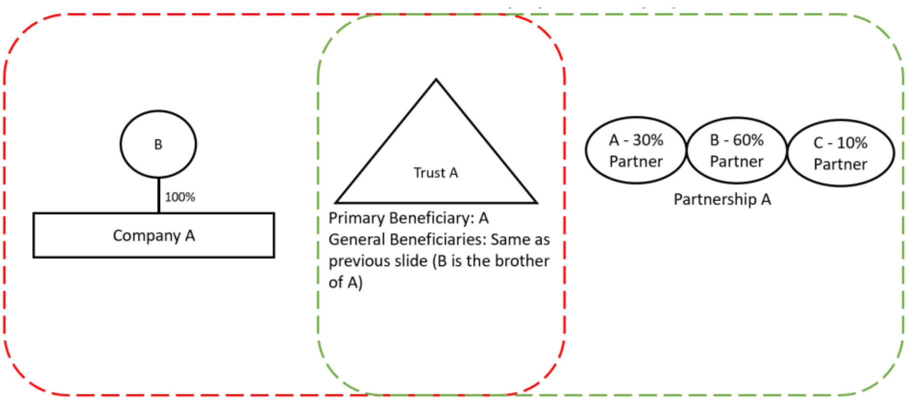


(d) section 71(6) Payroll Tax Act – any person who **may benefit** from a discretionary trust as a result of the trustee exercising a power or discretion (for example a trustee exercising their power to appoint income or capital in favour of a beneficiary) or failing to exercise a power or discretion (for example by way of the default income or capital provisions contained in the trust deed), is taken to be a beneficiary of the trust in respect of more than 50% of the value of the interests in the trust. In other words, any *potential* beneficiary of a discretionary trust will be deemed to have a controlling interest in that discretionary trust;



(e) section 71(7) Payroll Tax Act – If a group of persons (**Group A**) has a controlling interest in the business of a trust (**Trust A**) and the trustee of Trust A (whether with someone else or not) has a controlling interest in the business of a company (**Company A**), then Group A is deemed to have a controlling interest in Company A; and

(f) section 71(8) Payroll Tax Act – If a group of persons (**Group A**) has a controlling interest in the business of a trust (**Trust A**) and the trustee of Trust A (whether with someone else or not) has a controlling interest in the business of a partnership (**Partnership A**), then Group A is deemed to have a controlling interest in Partnership A.



3.17 Much like the Grouping of Corporations, grouping by Common Controllers can mostly be identified by revenue authorities through data matching provided through ASIC, income tax returns and potentially information disclosed about trusts and partnerships for other purposes.

Tracing of Interests

3.18 Section 72 Payroll Tax Act states that a 'relevant entity' and a company will be grouped if the 'relevant entity' has a 'controlling interest' in the company.

3.19 Interestingly, the phrase 'controlling interest' in this section adopts an entirely different definition to the term used in section 71 Payroll Tax Act. This is due to the specific relationship between an entity and a **corporation** as opposed to the various other structures mentioned in section 71 Payroll Tax Act.

3.20 Section 72(2) Payroll Tax Act defines a controlling interest in this section where:

(a) the corporation has share capital;

(b) the **relevant entity** has an **interest** in the corporation; and

(c) the value of that interest is more than 50%.

3.21 The requirement of whether a company has share capital is satisfied provided the company is limited by shares.

3.22 Whether a 'relevant entity' has an 'interest' in that company of more than 50%, however, requires an understanding of some defined terms in this section.

3.23 'Relevant entity' is defined in section 74B Payroll Tax Act to mean a person or two or more **associated persons**. With 'associated persons' being defined as any of the following:

(a) **related persons**;

(b) individuals who are partners in a partnership;

(c) private companies in which common shareholders have a majority interest;

(d) trustees of trusts, other than public unit trust schemes, of which there is a common beneficiary;

(e) a private company and a trustee of a trust, other than a public unit trust scheme, if a related body corporate of the company is a beneficiary of the trust.[15]

3.24 'Related persons' is defined in section 74D Payroll Tax Act to include:

(a) spouses (including de facto partners[16] and civil partners), parents, children and siblings;

(b) related bodies corporate;

(c) majority shareholders of a company;

(d) an individual who is a beneficiary of a trust as well as the trustee of that trust; and

(e) a private company that is a beneficiary of a trust as well as the trustee of that trust.

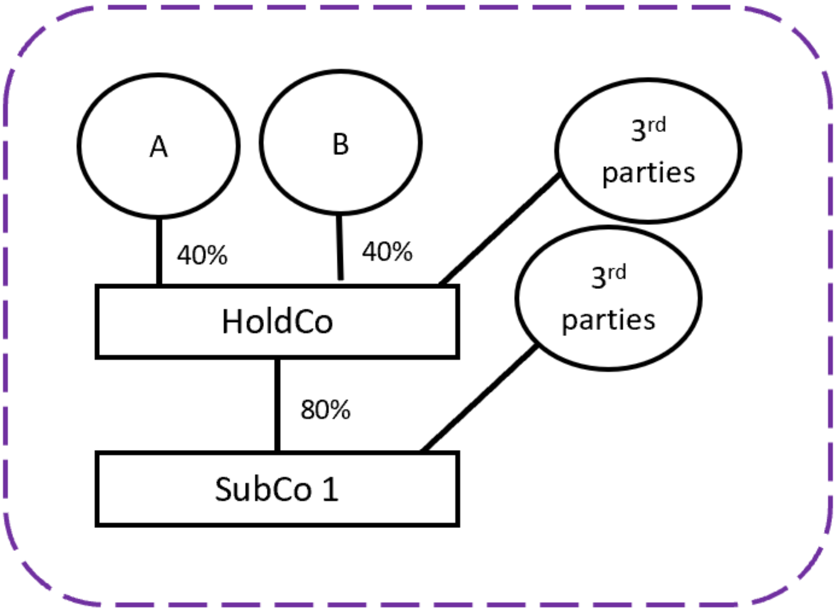
3.25 The question therefore becomes if any combination of the person/s identified at paragraphs 3.23 and/or 3.24 hold an interest of 50% in a company.

3.26 **Interest** is defined in section 74D Payroll Tax Act to include a direct interest[17], indirect interest[18] or aggregated interest.[19]

3.27 A direct interest includes the ability (whether directly or indirectly) to exercise a voting power attached to *any* voting shares issued by the company. The value of such interest is equal to the percentage equivalent to the proportion of the voting power of *all* voting shares issued by the company.

[15] Section 74C *Payroll Tax Act 1973* (QLD)
[16] De facto partners adopt the meaning given to it under section 32DA *Acts Interpretation Act 1954* (QLD) provided the persons have/had lived together for at least 2 years on a genuine domestic basis within the meaning of that section
[17] Defined in section 74E *Payroll Tax Act 1973* (QLD)
[18] Defined in section 74F *Payroll Tax Act 1973* (QLD)
[19] Defined in section 74G *Payroll Tax Act 1973* (QLD)

3.28 An indirect interest in a company is an interest that can be traced through a direct interest (for example, shareholders in a head company could be deemed to have an indirect interest in the subsidiaries regardless of how companies that interest passes through). The value of such an indirect interest is calculated by multiplying the percentages through the chain of companies to the relevant entity.[20]



3.29 The aggregated interest combines a 'relevant entity's' total direct and indirect interest in the company.

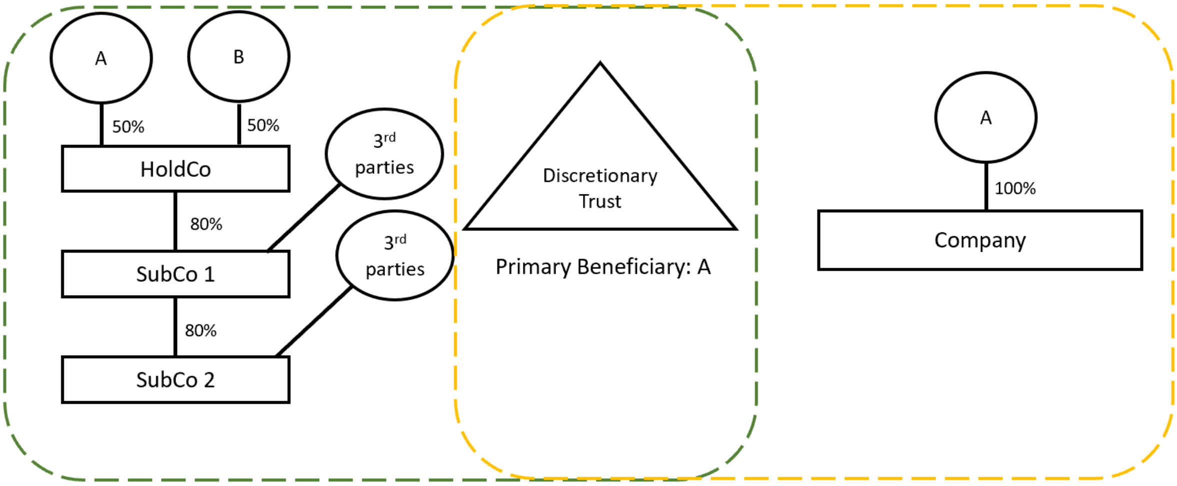
Common Group Members – smaller groups subsumed into larger groups

3.30 Section 73 Payroll Tax Act states that:

(a) two or more groups of businesses will be combined to constitute a larger group if there is a common member; or

(b) if two or more members of a group have a controlling interest (the **Controllers**) in a business (**Business Entity**), then the Controllers and the Business Entity will be grouped.

[20] Example 1 taken from section 74F *Payroll Tax Act 1973* (QLD). A relevant entity has a direct interest (with a value of 80%) in corporation A. Corporation A has a direct interest (with a value of 70%) in corporation B. The value of the relevant entity's indirect interest in corporation B is 80% * 70% = 56%. For section 72, the relevant entity has a controlling interest in corporation B



3.31 Although this section largely follows the theme of grouping:

(a) common persons; and

(b) persons with controlling interests in a business entity,

the ability for otherwise unrelated groups of businesses to be grouped together due to a common controller or business entity emphasises the breadth of these provisions.[21]

4 Consequences of being grouped

4.1 The consequences of having businesses grouped can be summarised as follows:

(a) the taxable wages of each business will be aggregated and only one tax-free threshold will be applicable for the entire group;

(b) each member of the group is jointly and severally liable for any amount that another group member fails to pay whether or not that member was an employer during the period of the unpaid amount.[22]

4.2 These consequences may bring cause for concern for business owners as they suddenly become liable for payroll tax when they were under the impression that the taxable wages of their business/es was below the payroll tax tax-free threshold.

4.3 In addition, if other entities under the business owner's control are then subsequently deemed as part of the business owner's group (regardless of whether that entity

[21] As will be discussed further below, the legislators appreciated the broadness of these grouping provisions and therefore provided the Commissioner of State Revenue a discretion to potentially exclude members from a group when satisfied with certain conditions - Explanatory Memorandum to the Pay-roll Tax (Harmonisation) Amendment Bill 2008, page 11 under the heading "Grouping"
[22] Section 51A *Payroll Tax Act 1971* (QLD)

conducts the same business or not, or even an active trading business)[23], the assets held by those entities are at risk if the payroll tax liability is unable to be repaid.

5 Case study: the effect of a discretionary trust

5.1 Below is an example of how a discretionary trust could inadvertently group family businesses, creating an unnecessary risk for small business owners.

Example

5.2 **Nick** and **Matt** are brothers. Their parents are **John** and **Jane**.

5.3 John and Jane are now self-funded retirees, relying on income from their share and property investments in the Jones Family Trust. The primary beneficiaries of the Jones Family Trust are listed as being John, Jane and Nick.[24]

5.4 Nick operates a fast food franchise through various related corporate bodies, and although he is looking to acquire additional fast food franchises, he is currently organising his affairs so that he is able to hire additional staff as his business grows. His entities are currently paying $800,000 in wages.

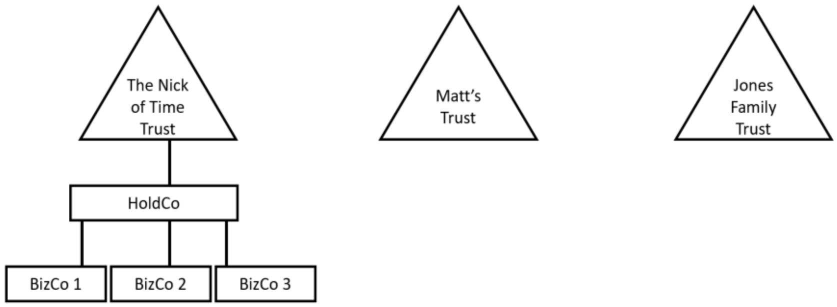
5.5 Nick's discretionary trust (**The Nick of Time Trust**) wholly owns the shares in the head company of Nick's related corporate bodies. Nick is listed as the primary beneficiary of The Nick of Time Trust.

5.6 Matt currently owns a dental clinic and operates the business through his own discretionary trust – Matt's Trust. He currently is paying approximately $900,000 in wages to his dentists and staff and is holding off engaging new dentists until after he restructures his business. Matt is listed as the primary beneficiary of Matt's Trust; however, Matt's Trust includes the usual secondary beneficiary class of the 'primary beneficiary's parents, siblings and children'.

5.7 The following diagram summarises the structure for the family:

[23] The definition of 'business' in section 66 *Payroll Tax Act 1971* (QLD) regarding entities able to be grouped includes '*any other activity carried on for fee, gain or reward*' and '*the activity of holding money or property used in connection with another business*'. This means that even the investing of money to make a gain could arguable be considered the conducting of a business under the *Payroll Tax Act 1971* (QLD)

[24] The reason for not naming Matt as a primary beneficiary in the Jones Family Trust is due to the fact that Matt was not born at the time of the trust being established



What could happen

5.8 From Nick and Matt's perspective it is likely that unless they have sought appropriate legal advice they each regard their respective businesses as not being liable for payroll tax.

5.9 Unfortunately, a technical grouping arises through Nick and Matt having discretionary trusts in their structure.

5.10 Without any other information regarding the terms of the trust deed or the respective family circumstances, it could be argued that Nick has a controlling interest in The Nick of Time Trust and Matt's Trust as he is a person able to potentially benefit from those trusts.[25]

5.11 As Nick has a controlling interest in both trusts, The Nick of Time Trust and Matt's Trust are grouped under section 71(5) Payroll Tax Act (**Group 1**).

5.12 As Nick has a controlling interest in The Nick of Time Trust and the Nick of Time Trust (on its own) has a controlling interest in Nick's holding company of related bodies corporate, The Nick of Time Trust and the holding company are grouped under section 71(7) Payroll Tax Act (**Group 2**).

5.13 Finally, as all of Nick's business entities are related body corporates, they are grouped under section 69 Payroll Tax Act (**Group 3**).

5.14 Under section 73 Payroll Tax Act:

(a) the Nick of Time Trust is a member of Group 1 and Group 2, thereby grouping those entities into a larger group.

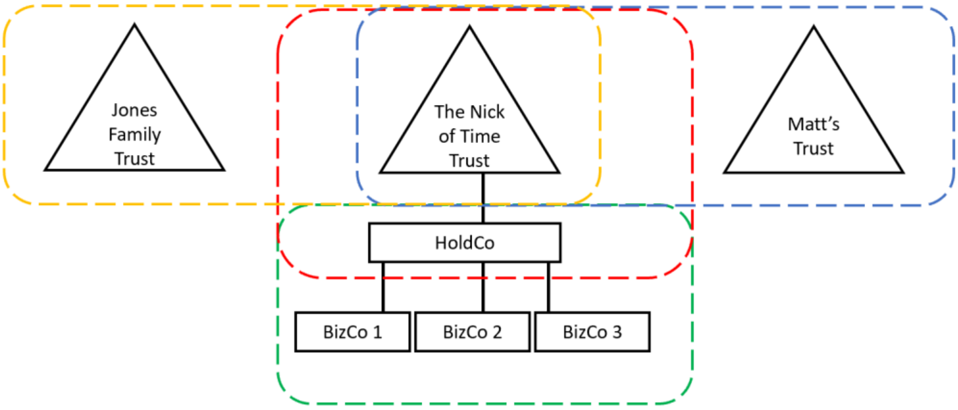
[25] This is a straight application of sections 71(2)(g) and 71(6) *Payroll Tax Act 1971* (QLD)

(b) the holding company is a member of Group 2 and Group 3, thereby bringing Group 3 into the larger group containing Group 1 and Group 2.

5.15 Nick and Matt's business will be aggregated for payroll tax purposes and there will be a payroll tax liability to be paid that their entities are jointly and severally liable for.

5.16 In addition to the above potential group, there is a further technical grouping that can be argued in that Nick has a controlling interest in the Jones Family Trust, that would form part of the larger payroll tax group between Group 1, Group 2 and Group 3.

5.17 Whilst the Jones Family Trust will not contribute additional taxable wages to the calculation for payroll tax, John and Jane's entire retirement savings are potentially at risk if both Nick and Matt (through their business entities) are unable to pay the payroll tax liability.[26]



6 'De-grouping' provisions

6.1 As seen from the example above, notwithstanding that entirely unrelated family businesses can be grouped for payroll tax purposes due to discretionary trusts being used, the grouping provisions are very broad.

6.2 The legislators did acknowledge this broadness, and included a discretion for the Commissioner of the relevant revenue authority to exclude certain entities from groups if certain circumstances are satisfied.[27]

6.3 Broadly, the Commissioner may exclude an entity from a group if the Commissioner is satisfied that the business carried on by that entity is carried on independently and

[26] It is also important to appreciate that 'the carrying on of a trust, including a dormant trust', could also be a *business* able to be grouped for payroll tax purposes under section 66 *Payroll Tax 1971* (QLD)
[27] Section 74 *Payroll Tax Act 1971* (QLD)

not connected with the business carried on by any other member of the group. In deciding whether a business satisfies this, the Commissioner must have regard to:

(a) the nature and degree of ownership and control of the businesses carried on by the entity and the other members of the group;

(b) the nature of the businesses; and

(c) any other matters the Commissioner considers relevant.

6.4 It is important to appreciate that under section 74(4) Payroll Tax Act, the Commissioner cannot make an exclusion order if the entities are related body corporates.

6.5 Otherwise, matters that the Commissioner may consider relevant when deciding to exclude an entity from a wider group have been outlined in Harmonised Revenue Public Ruling PTA 032.2 to include:

(a) the nature and extent of any commercial transactions between the members, including the value and percentage of the employer's total business which is conducted with other members of the group;

(b) the extent to which members share resources, facilities or services, including premises, staff, management and accounting services;

(c) the extent to which the employer controls or is involved in managerial decisions and day to day administration of the other members and the extent to which other members control or are involved in managerial decisions and day-to-day administration of the employer;

(d) the extent to which there are financial interdependencies, including intra-group loans or guarantees and common banking facilities, and the terms and conditions attached to such agreements;

(e) the degree to which there is a connection between the employer and other members of the group in the purchase or sales of goods and services;

(f) the extent to which there is a connection between the nature of the businesses of the employer and other members of the group; and

(g) the extent to which there is a connection between the ultimate owners of the employer and other members of the group.

6.6 In considering the above factors, the Commissioner must be satisfied that:

(a) there is no continuous course of active and significant relationship, in a business or commercial sense, between the carrying on of the employer's business and the carrying on of businesses conducted by any other member of the group; and

(b) the connections which do exist are no more than casual, irregular or occasional occurrences.

6.7 Therefore, in circumstances where businesses may be inadvertently grouped with unwanted businesses through technical sections of the grouping provisions, steps can be taken to 'de-group' them by applying to the Commissioner to exercise their discretion. However the onus is on the applicant to prove that their business is substantially independent and not connected to any other business.

6.8 That said, the ability for the Commissioner to 'de-group' is merely at the Commissioner's discretion, so ideally clients and their advisors would seek advice prior to identifying structures to undertake business activities to ensure a technical grouping is not triggered in the first instance – so that the business is not in a situation where they have to rely on the Commissioner's discretion being exercised.

6.9 The difficulty in obtaining a favourable 'de-grouping' ruling with the Commissioner in cases where businesses have clear links with one and another is emphasised in the New South Wales case discussed under section 7 below.

6.10 As outlined under section 2, notwithstanding that this case relates to the New South Wales payroll tax legislation, given the harmonisation of the payroll tax rules across the States, the rationale and analysis conducted in these cases can strongly influence the application of the Queensland payroll tax grouping provisions.

7 Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue[28]

7.1 Cessnock's Case related to the grouping of businesses operated by three brothers for the financial year commencing 1 July 2013 onwards.

Facts

[28] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 (**Cessnock's Case**); *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2018] NSWCATAP 147

7.2 Founded in the 1950s by Mr O'Neill (the brothers' father) in the Hunter Valley as 'O'Neills Tyres', the business grew into various retail outlets throughout the Newcastle and Hunter Valley region.

7.3 At some point, Mr O'Neill passed the business down to his three sons, Mark, Bernard and Stephen.

7.4 Due to family disagreements, the brothers agreed between them to split the business into three, of which they would each separately control a business.

Mark's business

7.5 Mark operated his business from a store in Cessnock selling tyres for passenger vehicles. The business was operated from the Mark O'Neill Family Trust (**Mark's Trust**), a discretionary trust with potential beneficiaries including Mark, his wife Elizabeth, his children and grandchildren as well as his brothers. The trustee for Mark's Trust was Cessnock Tyres Pty Ltd (**CT P/L**) of which Mark and Elizabeth were the directors and shareholders.

Bernard's business

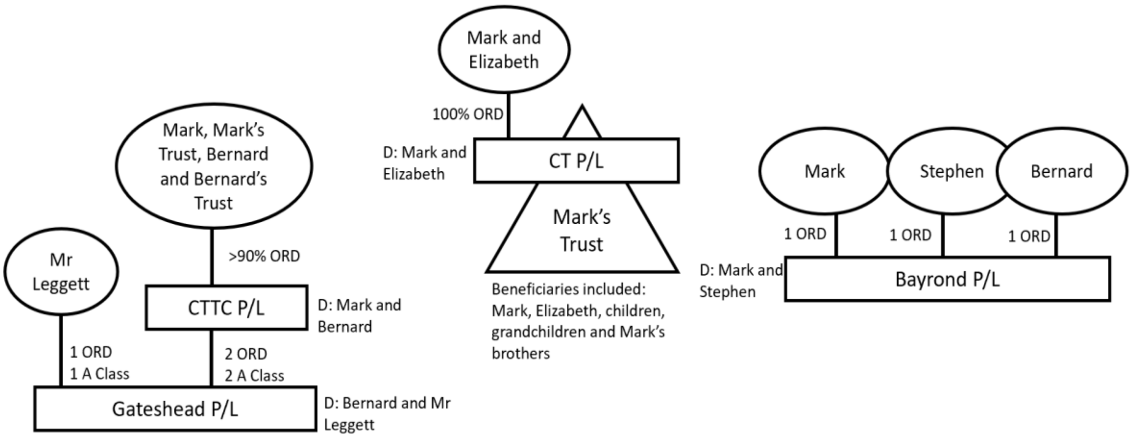
7.6 Bernard operated his business from various stores located in Gateshead, Belmont, Warners Bay and Beresfield selling tyres for passenger vehicles. The business originally operated through Cessnock Truck Tyre Centre Pty Ltd (**CTTC P/L**), of which Mark and Bernard were directors and Mark and Bernard (as well as their respective family trusts) were shareholders of over 90% of the voting shares. However, in 2011, CTTC P/L sold its business to O'Neill Tyres Gateshead Pty Ltd (**Gateshead P/L**). Gateshead P/L's directors were Bernard and a Mr S Leggett. The shareholders of Gateshead P/L included CTTC (holding 2 ordinary and 2 A class shares) and Mr S Leggett (holding 1 ordinary and 1 A class share).

Stephen's business

7.7 Stephen operated his business from various stores located in Wallsend, Rutherford and Kurri Kurri selling tyres for passenger vehicles. The business was operated from Bayrond Pty Ltd (**Bayrond P/L**), of which Mark and Stephen were the directors and each of Mark, Bernard and Stephen held 1 ordinary share in the company.

Diagrammatic summary

7.8 A diagrammatic summary of the structure of each brothers' business is as follows:



Business arrangements

7.9 Despite each brother appearing to have their own 'allocated' business, there were various arrangements integrating each business to the other, namely:

(a) there were various loans between each business exceeding $50,000;

(b) Mark's Trust, Gateshead P/L and Bayrond P/L were franchisees/dealers under Goodyear Auto Service agreements with Mark being one of the personal guarantors under the arrangement;

(c) Mark's Trust, Gateshead P/L and Bayrond P/L had supplier agreements with other tyre manufacturers/distributors, enjoying volume discounts based on the aggregate purchase of the three entities;

(d) until July 2014, Mark's Trust received rebates from Michelin and paid a proportionate amount to Gateshead P/L and Bayrond P/L;

(e) Mark's Trust, Gateshead P/L and Bayrond P/L would sell tyres (at a price higher than wholesale price but lower than retail price) to each other when certain entities were short on stock;

(f) all businesses were listed together on the same website under the O'Neills Tyre brand (however, the website did state each business was independently run);

(g) Mark's Trust, Gateshead P/L and Bayrond P/L advertised as the O'Neills Tyre group by offering specials across the 'group'; and

(h) Mark's Trust, Gateshead P/L and Bayrond P/L used the same accounting firm who also provided a common registered office for all relevant entities (however, it was understood that each business dealt separately from the other in relation to their accounts and tax returns).

7.10 In contrast:

(a) Mark's Trust, Gateshead P/L and Bayrond P/L had separate banking arrangements and telephone and fax numbers;

(b) there were no common employees; and

(c) there was evidence supporting the notion that the decision making in Mark's Trust, Gateshead P/L and Bayrond P/L were conducted in the best interest of the relevant brother's family.

Grouping

7.11 The Chief Commissioner of State Revenue (**CCSR**) grouped the brothers' business on the following grounds:[29],[30]

(a) Group 1 - Mark's Trust and Bayrond P/L formed a group because Mark and Bernard held a controlling interest in Mark's Trust (by way of both being a potential beneficiary) as well as a controlling interest in Bayrond P/L's business (as together they held more than 50% of the voting shares in Bayron P/L);

(b) Group 2 – CTTC P/L and Gateshead P/L were grouped by way of being related body corporates;

(c) Group 3 – CTTC P/L and Bayrond P/L were grouped through the tracing of interests in corporations because Mark and Bernard (as brothers) are related persons and therefore associated persons. As associated persons, they held a controlling interest of more than 50% in each of CTTC P/L (greater than 90%) and Bayrond P/L (66%).

(d) Group 1 and Group 3 are merged into a larger group because Bayrond P/L is a common member (Group 1+3).

[29] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [38]

[30] *Payroll Tax Act 1971* (QLD) contains identical wording to the sections 72 to 74 *Payroll Tax Act 2007* (NSW) referred to in *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at sections 71 to 73 *Payroll Tax Act 1971* (QLD)

(e) Group 2 and Group 1+3 are merged because CTTC P/L is a common member.

7.12 Relevant in the context of discretionary trusts and grouping for payroll tax purposes:

"The basis for the taxpayer [Mark's Trust] *being in Group 1 was the commonality of the beneficiaries of MOFT* [Mark's Trust]*. This is because the objects included the brothers (here Bernard) of the specified beneficiary/principal (here Mark) and s72(2)(g) and (6) were invoked*."[31]

7.13 The analysis does not distinguish whether Bernard was a beneficiary who received income or capital of Mark's Trust. It is enough to be a potential beneficiary, for the relevant control deeming provisions to apply.

Attempt to de-group

7.14 It is noted that attempts were made to break Mark's Trust away from the group by having Bernard and Stephen 'exclude' themselves as beneficiaries from Mark's Trust.

7.15 However, due to improper drafting, this attempt was unsuccessful.[32]

'De-grouping' application

7.16 Application was made to the Chief Commissioner of State Revenue for New South Wales (**CCSR**) to 'de-group' Mark's Trust on the basis that the business conducted by Mark's Trust was independent and not connected with the other members of the Group.

7.17 The CCSR refused to de-group (**CCSR's Decision**) and application was made for the Tribunal to determine whether the CCSR's Decision was correct.

Initial decision

7.18 The Tribunal reviewed the CCSR's Decision by considering the nature and degree of:

(a) "ownership; and

(b) control

of the businesses; and

[31] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [39]
[32] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [41]

the nature of the businesses."[33]

7.19 In respect of 'ownership', the Tribunal stated that '*the legal position is all that can be considered here*'.[34]

7.20 In respect of 'control', the Tribunal acknowledged that although there was shared control between various brothers of certain entities (such as Mark's involvement at a directorship level of Bayrond P/L and CTTC P/L), '[I]*n a practical sense though, control of the management and the day to day operations of each of the businesses has been ceded by the 'non-active' brothers to the relevant brother to control 'his' businesses'.*[35]

7.21 In respect of the nature of the business, the Tribunal noted the following:

(a) the businesses are of a similar nature;

(b) the businesses sell similar products under a common banner;

(c) each business is a Goodyear Franchise Dealer;

(d) no weight was given as to the personal guarantees on the basis that it dated back to a time of 'greater family solidarity';

(e) the businesses do not compete due to their geographical location (however nothing should be made of this fact);

(f) some (although not much) weight should be given to the rebate and marketing arrangements made, although "*these are an almost inevitable part of owning a franchise business and do not <u>of themselves</u> indicate connection or lack of independence…but there is a business incentive to maintain a connection so that rebates and volume discounts can be accessed";*[36]

(g) minor weight should be given to the intra-group sourcing of tyres;

(h) substantial weight was given to the importance of the businesses holding themselves out to the public as O'Neill Tyres through their website and broader advertising;

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[33] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [44]
[34] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [48]
[35] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [49]
[36] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [54]

(i) this is more so the case than each business being franchisees of Goodyear (as it would be unreasonable to suggest all franchisees of a brand being grouped);

(j) although the holding out of the businesses as O'Neills Tyres may not suggest a lack of independence, it did clearly show the businesses maintained some sort of co-ordination;

(k) substantial weight was given to the 'intragroup' loans given the significant size of the debts and the fact that there were no short term trade debts; and

(l) no weight was given to the fact that all businesses had the same accountant and same registered office on the basis that each business was treated as their own independent business with their own schedule for filing relevant forms.

7.22 Based on the above analysis, the Tribunal found that the CCSR's Decision was correct.

7.23 Following this decision, a notice to appeal was lodged[37] that was ultimately rejected on the basis that no legal or other error was identified in the original decision.

8 Tips and traps

8.1 Cessnock's Case highlights the difficulty in obtaining a favourable ruling to de-group an entity from a wider payroll tax group where there may be some connection between separate family businesses. In fact, in that case, an application to de-group was initially made in 2012 (which was not contested) before a second attempt was made on 25 September 2015. The difference between those dates, was that an attempt was made to structure Mark's Trust correctly to 'break' the grouping connection. As mentioned above, however, the attempted 'restructure' was deemed ineffective.

8.2 Cessnock's Case illustrates why it is important to consider payroll tax implications when setting up entities to conduct businesses to ensure technical grouping for payroll tax purposes is not triggered. The case also illustrates that it is important that businesses keep in mind factors that may impact on the perception of independence and connectivity of businesses – for instance common websites, bulk purchase

[37] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2018] NSWCATAP 147

arrangements etc. It is important for businesses and advisers to monitor the various factors on an ongoing basis, as it is not uncommon for businesses to start of not connected but over time lose their independence. For instance due to inter-entity loans, changes in shareholdings, use of common employees etc.

8.3 This need for on-going review by businesses and their advisors is particularly important for any family group structures involving trusts as if inadvertent grouping is triggered because there is a potential beneficiary of more than one trust, causing smaller groups to be subsumed into one large group, then it is important to evidence that notwithstanding inadvertent grouping being triggered that the businesses are actually independent and not substantially connected. For instance, in the Nick and Matt case study, each of the son's entities would need to show they had sufficient working capital to fund any expansion of their respective businesses, independent of any distributions that may have been made to them from the Jones Investment Trust (their parent's investment trust).

8.4 As the focus of this paper relates to the potential for discretionary trusts to inadvertently group family businesses together, the 'structuring' solutions discussed will be tailored with respect to discretionary trusts.

8.5 That said, 'structuring' solutions for other structures such as companies, unit trusts and partnerships can include:

(a) a transfer of interests in the relevant entity to ensure certain persons do not have a controlling interest of 50% or more; or

(b) appoint or retire certain people as controllers/directors for relevant entities.

The issue with discretionary trusts

8.6 The existence of a discretionary trust in a family group is unique in causing entities to be grouped for payroll tax purposes. Unlike most other structures where persons with an interest in that structure would have a clearly identifiable voting or equity share – the hallmark feature of a discretionary trust is that no beneficiary can be said to have a fixed interest in income or an underlying trust assets.

8.7 This is because:

(a) the trustee of the trust may exercise a discretion as to the proportion of income or capital of the trust fund that a potential beneficiary may receive[38]

[38] *Gartside v Inland Revenue Commissioners* [1986] AC 553 at 696

(thereby making it impossible for anyone other than the trustee, or arguably the persons in control of the trustee, to know what proportion of income or capital in a financial year will be distributed to a beneficiary); and

(b) those other beneficiaries with an identifiable interest in the income or capital of the trust fund will only receive such interest if the trustee fails to otherwise exercise their discretion (in other words, those beneficiaries only have a *mere expectancy* to receive any of the trust fund and are unable to force a trustee to distribute trust funds in their favour,[39] subject to the rule of *Saunders v Vautier*[40]).

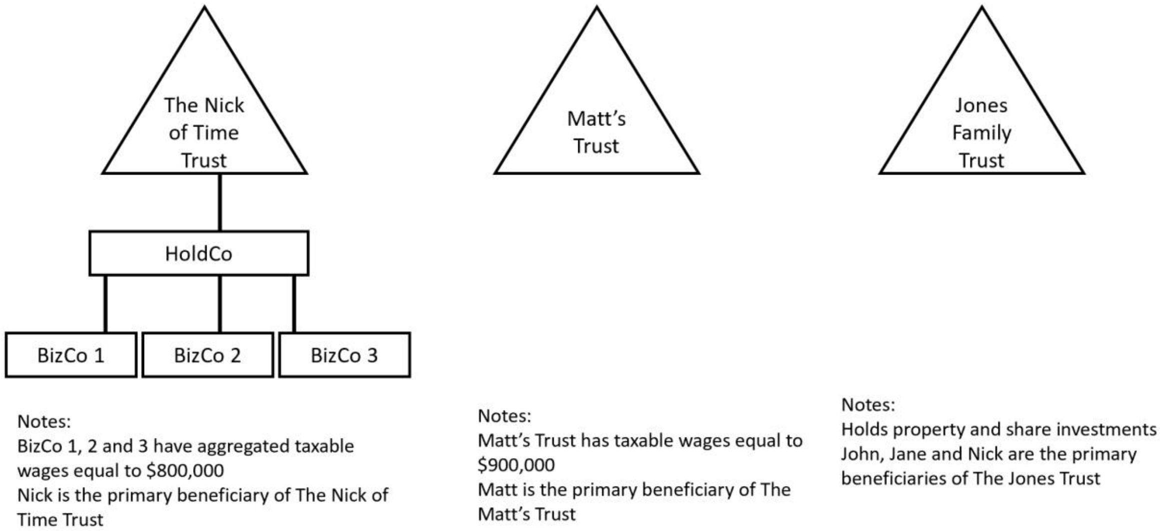
8.8 The result of there being no beneficiary with an identifiable interest in a discretionary trust has required such wording that '*a person who may benefit from a discretionary trust…is taken for this part to be a beneficiary of the trust in respect of more than 50% of the value of the interests in the trust*'.[41]

8.9 This is required to remove any potential anti-avoidance through using trusts with no fixed interests or distribution history as employment entities, separate from any trading trust.

8.10 The issue, then, when structuring a discretionary trust to manage the payroll tax grouping provisions, is ensuring the beneficiaries of the trust are limited those who could be grouped with the trust.

8.11 Each potential structuring solution considered below will be applied against the case study at section 5, and whose diagram is summarised below again for your convenience:

[39] *Pearson v Inland Revenue Commissioner* [1981] AC 753
[40] *Saunders v Vautier* [1841] EWHC Ch J82
[41] Section 71(6) *Payroll Tax Act 1971* (QLD)



8.12 For the avoidance of doubt, an extract of a common general beneficiary class in a discretionary trust has been provided as follows:

(a) *a Primary Beneficiary;*

(b) *a Spouse of the Primary Beneficiary;*

(c) *any parent or grandparent of the persons named in paragraphs (a) and (b) above;*

(d) *any Children, lineal descendant or remoter issue of the persons named in paragraphs (a) to (b) above;*

(e) *any sister, brother, niece, nephew of the persons named in paragraphs (a) and (b) above;*

(f) *any Children, lineal descendants or remoter issue of the persons named in paragraph (e) above;*

(g) *any Spouse of the persons named in paragraphs (a) to (f) above;*

(h) *the trustee of any trust which any Beneficiary is a member of a class of beneficiaries named in that trust, or holds units in that trust;*

(i) *any company that a Beneficiary, or this Trust holds any type of share or is a director in that company;*

(j) *the personal representatives of the deceased estate of any Beneficiary;*

(k) *any person who is employed or engaged by the Trustee of this Trust in the course of any business or activity carried on by the Trustee of this Trust;*

(l) *any charity or religious entity.*

Structuring it right

8.13 The simplest (although likely the most uncommon) way in managing discretionary trusts grouping family businesses would be to tailor the discretionary trust terms prior to establishment.

8.14 That is, ensuring the persons who are able to benefit under the trust deed are limited so unwanted family members cannot be argued as having a controlling interest in a discretionary trust.

8.15 As provided above at paragraph 8.12, it is standard for the beneficiary class of a discretionary trust to include ‘any sister or brother’ of a primary beneficiary.

8.16 This potentially leaves that sister or brother of a client with a controlling interest in that discretionary trust, which, if combined with any other controlling interest they have in their own structures, would cause the client’s discretionary trust to be grouped with the siblings’ structure.

8.17 A similar argument could be made with respect to your client controlling their sibling’s structures as well if there is a discretionary trust involved with the sibling.

8.18 To manage this risk, any new discretionary trust would have the beneficiary class tailored to only those persons who should be a ‘controller’ for that trust (i.e. it shouldn’t include other family members if those family members are not to ‘control’ the trust).

8.19 Unfortunately though, this would need to apply to discretionary trusts for all family members, as well as all future discretionary trusts established within that family group. This would substantially complicate their affairs and special care would need to be taken to ensure distributions made from trusts are valid.

8.20 Let’s consider this solution to our case study of Nick and Matt. A summary of how the family businesses were grouped is outlined at 5.11 to 5.17.

8.21 If:

(a) the beneficiaries of The Nick of Time Trust was limited to only Nick, his wife and his children and grandchildren;

(b) the beneficiaries of Matt’s Trust was limited to only Matt, his wife and his children and grandchildren; and

(c) the beneficiaries of The Jones Family Trust was limited to only John, Jane and Nick,

then:

(d) Nick will not be deemed to have a controlling interest in Matt's Trust;

(e) Nick would still have a controlling interest in The Nick of Time Trust;

(f) Matt's Trust (operating Matt's dental business) and The Nick of Time Trust (which is grouped with Nick's fast food chain business) does not have Nick as a controlling interest holder;

(g) the two businesses will therefore not be grouped for payroll tax purposes.

8.22 Although technically Nick continues to have a controlling interest in The Jones Family Trust, as Matt and Nick's business are not grouped for payroll tax purposes, there will be no payroll tax liability that The Jones Family Trust would be jointly and severally liable for.

8.23 The example above is simplistic in that the beneficiary class of a discretionary trust is limited to a few individuals, however, the risk of even just including 'parents' as part of the beneficiary class could be catastrophic in causing the entities to be grouped. This is due to John and Jane technically having a controlling interest in all three trusts.

8.24 As such, should this solution be considered, sufficient thought must be given to ensure the right persons are identified as 'beneficiaries' for the discretionary trust.

8.25 The broad classes normally included must be removed and the classes, confined to only those likely to receive a distribution.[42]

Varying the trust deed

8.26 Most clients will not have the chance to properly structure their discretionary trust terms in contemplation of the payroll tax grouping provisions. Whether it be due to them having operated a business for years, or not having contemplated expanding to such a degree, the more likely solution is to assist clients in changing the beneficiary class in their trust deed after establishment.

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[42] Please consider reading the following article for other arguments in tailoring the beneficiary class of a discretionary trust: D Lam, "The discretionary beneficiary – thoughts on defining the beneficiary class", (2017) Vol 20(5) *The Tax Specialist*, 280-286

8.27 That is, rather than ensuring the beneficiary class is tailored correctly prior to establishment, this solution requires a deed of variation to be prepared to change the beneficiary class.

8.28 Unfortunately, varying the terms of a trust deed after the trust has been established is a much more complex affair as there may be potential capital gains tax (**CGT**) and stamp duty consequences that must be considered in addition to the drafting requirements.

8.29 In relation to CGT:

(a) care must be taken to ensure that any variation of a discretionary trust does not trigger a CGT event;

(b) some of the more common CGT events that can occur with a variation of a discretionary trust includes:

(i) CGT event E1 – where assets have been settled on a new trust; and

(ii) CGT event E2 – where assets are taken to be transferred to a new trust;

(c) the risk of varying the terms of a trust deed is that if the variation is too broad, there may be an argument that a new trust has been established;

(d) this is colloquially called a 'resettlement';

(e) fortunately, there has been guidance from the Courts suggesting that provided there is a continuum of:

(i) the terms of the trust deed;

(ii) the trust property; and

(iii) the membership of the trust,

as well as the changes having been made under a valid trust power, then there should not be a resettlement;[43]

(f) the Australian Taxation Office has released Tax Determination 2012/21 that confirms:

[43] *Commissioner of Taxation v Clark* [2011] FCAFC 5

> *"Relevantly, the principals established by those cases are also relevant to the question of the circumstances in which CGT event E1 or E2 may happen as a result of changes being made to the terms of an existing trust pursuant to a valid exercise of a power in the deed (including a power to amend). In light of those principles,* ***the ATO accepts that a change in the terms of the trust pursuant to exercise of an existing power (including an amendment to the deed of a trust), or court approved variation, will not result in a termination of the trust*** *and, therefore, subject to the observation in paragraph 27* [which relates to when trust property are held under a new charter of obligations] *will not result in CGT event E1 happening."*[44].

8.30 Therefore, provided a deed of variation is prepared using a valid power of the trust deed, there *should* be no adverse CGT consequence.

8.31 Whether a discretionary trust has a valid power or if a valid power is used to vary the deed, however, is an entirely different question that requires a detailed analysis of the specific wording of the trust deed's variation power. This is particularly important when dealing with variation powers that:

(a) only refers to one of the following two words, being '*trust*' or '*power*'; or

(b) imposes certain restrictions on what clauses in the trust deed can be varied.[45]

8.32 There is a long line of case law acknowledging the difference in a 'mere power' and a 'trust power' and care must be taken to ensure the variation power is exercised appropriately.[46]

8.33 In relation to Queensland stamp duty:

(a) a variation of beneficiaries could potentially result in a change to a trust interest;

(b) section 57 *Duties Act 2001* (QLD) defines a trust interest to be a *"person's interest as a beneficiary of a trust*" and where the trust is a discretionary trust

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[44] Tax Determination 2012/21 at paragraph 24

[45] Cases such as *Jenkins v Ellett* [2007] QSC 154 and *Mercanti v Mercanti* [2016] WASCA 206 provides practical examples of variation powers containing restrictions on what can be varied with the later case considering two discretionary trust deeds with differing terms where, notwithstanding the same variation was made to the trust, one discretionary trust's deed had sufficient power to effect the change while the other did not

[46] Please consider reading the following article for an understanding between the difference of a 'mere power' and a 'trust power' in the context of discretionary trusts: J Ioannou and D Hii, "Trusts, powers and default appointment clauses", (2015) Vol 49(6) Taxation in Australia Blue Journal, 322-327

"only a taker in default of an appointment by the trustee can have a trust interest";

(c) a 'taker-in-default' of a trust is effectively the person who would benefit from the income or capital of the trust if the trustee failed to exercise any of its discretion;

(d) these persons are more commonly called the 'default beneficiaries';

(e) therefore, if a 'default beneficiary' of a trust is varied, there may be Queensland stamp duty consequences, hence the need to take care in varying the terms; and

(f) it is noted that there are potential exemptions to vary the default beneficiary, however, an analysis of those provisions will need to be undertaken accordingly.[47]

8.34 Unfortunately, there is no golden rule in determining whether varying the beneficiaries of a trust will result in adverse CGT or stamp duty consequences, and the answer will likely require an analysis on a case by case basis of:

(a) what changes to the beneficiaries are being proposed; and

(b) what powers does the trust deed contain.

Disclaimers and renunciations

8.35 Where it is not possible to vary the beneficiary class of a discretionary trust due to a lack of sufficient power under the trust deed for the trustee to exercise, beneficiaries may look to reject any interest they have in a discretionary trust.

8.36 It is settled that the "*law certainly is not so absurd as to force a man to take an estate against his will…and…the law will certainly, by some mode or other, allow him to renounce or refuse the gift*".[48]

8.37 Whilst there are various ways in which a beneficiary may reject their interest in a discretionary trust, the two most common methods are by way of 'disclaiming' or 'renouncing'.

8.38 Both methods impose an onus on a beneficiary to reject their interest, however:

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[47] Section 118 *Duties Act 2001* (QLD)

[48] *Ramsden v Federal Commissioner of Taxation* [2004] FCA 632 at 71 referencing *In re Gulbenkian's Settlements (No 2), Stephens v Maun* [1970] 1 Ch 408

(a) a successful disclaimer could take effect retrospectively;[49] while

(b) a renunciation would only be effective from the date of renunciation.

8.39 The effect a successful disclaimer or renunciation may have in the context of payroll tax grouping is that a person may no longer be deemed to have a controlling interest in a trust once they are no longer a beneficiary.

8.40 Steps would, however, need to be taken to consider the range of beneficiaries who are required to disclaim or renounce their interest.

8.41 In the example of Nick and Matt, it would not be enough for them to disclaim or renounce their interest in the other's trust but would also require them renouncing an interest in The Jones Family Trust. John and Jane would also be required to renounce their interest in The Nick of Time Trust and Matt's Trust to ensure they are not deemed to have a controlling interest in those trusts (and thereby grouping all three trusts).

8.42 Whilst the law surrounding disclaiming a trust interest is settled, it is important to appreciate that:

(a) notwithstanding the fact that disclaimers can take retrospective effect, the recent payroll tax case of *Smeaton Grange Holdings Pty Ltd*[50] has suggested that a "*subsequent alternation of those relationships* [being the relationship of who is a beneficiary of a discretionary trust] *by the unilateral act of a discretionary object cannot change the operation of the legislation* [being the payroll tax legislation]";[51]

(b) regardless of the fact that for payroll tax purposes, a disclaimer may not take effect retrospective, if a disclaiming of a trust interest is intended to affect the beneficiaries of a discretionary trust from the date of the disclaimer onwards, steps must still be taken to satisfy the settled requirements;

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[49] *J.W. Broomhead (Victoria) Pty Ltd (in liquidation) v J.W. Broomhead Pty Ltd* [1985] VR 891, at 892 and 930 to 936 and acknowledged by the ATO in ATO ID 2010/85

[50] *Chief Commissioner of State Revenue v Smeaton Grange Holdings Pty Ltd* [2017] NSWCA 184

[51] *Chief Commissioner of State Revenue v Smeaton Grange Holdings Pty Ltd* [2017] NSWCA 184 at 147, see also paragraph 143 whereby the Court acknowledges that the "*legislative scheme would be unworkable unless the determination of group membership in accordance with s 72 of the Payroll Tax Act can be undertaken by reference to the legal relationships as they exist between the relevant parties at the time the employer's liability to pay payroll tax arises. That determination must be made on the basis of the facts as they exist at the relevant time*"

(c) it is critical for beneficiaries to disclaim their interest in a trust within a reasonable time of becoming aware,[52] otherwise, it may be argued that disclaimers were only made to 'undo the past';[53]

(d) if disclaiming any prior distributions, then there needs to be an absolute rejection of such distribution as accepting any proportion and using it would amount to an acceptance of the distribution;[54]

(e) although it is not necessary to document a disclaimer,[55] doing so in writing and with communication to the trustee of the relevant discretionary trust will evidence that the disclaimed interest has been communicated.

8.43 In contrast with disclaiming an interest, as a renunciation of an interest does not purport to take effect retrospectively, the intent to reject any future interest need only be communicated to the relevant trustee of the discretionary trust.

8.44 In addition to communicating any rejection of an interest in a trust, it is important to properly classify the document rejecting the interest and ensure the relevant law is followed.

8.45 In Cessnock's Case, the brothers entered into a 'Rectification Deed' to renounce/disclaim their interests in the other brothers' trusts. The Tribunal largely agreed with the revenue authority that the document was not effective in breaking the group as:[56]

(a) the Rectification Deed sought to amend the definition of 'General Beneficiaries' in the 'Schedule of the Trust Deed' as oppose to outright renouncing a beneficiary's interest in the discretionary trust;

(b) as the Rectification Deed sought to 'rectify' the definition of 'General Beneficiaries', the law applicable for a successful rectification requires relevant persons (i.e. the drafters of the trust deed) to the trust deed to acknowledge that an error was made in the drafting of the trust deed and for such error to be rectified;

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[52] *JW Broomhead (Victoria) Pty Ltd (in liquidations) v JW Broomhead Pty Ltd* [1985] VR 891 at 930 to 931
[53] *Re Maurice Hannan Nominees Pty Ltd as trustee for the Maurice Hannan Family Trust & Ors v Federal Commissioner of Taxation* (2004) 57 ATR 1315 and note that in *Federal Commissioner of Taxation v Ramsden* (2005) 58 ATR 485, that a period of three years was considered well in excess of a reasonable time
[54] *Alderton v Federal Commissioner of Taxation* [2015] AATA 807
[55] *The Federal Commissioner of Taxation v Cornell* [1946] HCA 32; 73 CLR 394 at 401
[56] *Cessnock Tyres Pty Ltd v Chief Commissioner of State Revenue* [2017] NSWCATAD 368 at [41]

(c) the law requiring a successful rectification is contrasted with what is required at law for a disclaiming or renunciation of a beneficiary interest in that a rectification requires a mistake in the document that was not the intention of the parties;[57]

(d) the actual rectification was faulty as there was no definition of 'General Beneficiaries' in the schedule of the trust deed, thereby resulting in nothing to rectify;

(e) there was no authority provided confirming that the Rectification Deed was eligible to take retrospective effective (this could have been different had a formal Court ordered rectification was sought);

(f) even if the 'General Beneficiaries' were amended, as Mark and Bernard were still classified as a 'specified beneficiary' and default beneficiary respectively, they remained as potential beneficiaries of the trust (and therefore holding a 'controlling interest');[58] and

(g) regardless if the Rectification Deed was effective, the relevant businesses would still be grouped due to other grouping provisions.

8.46 Likewise, with varying a trust deed, the income tax and stamp duty consequences must be considered in relation to disclaiming and renouncing a beneficiary's interest in a discretionary trust.

8.47 The potential CGT event in this circumstance could include CGT event C2 where the effect of the disclaimer/renunciation is that a beneficiary's interest in a discretionary trust is surrendered.[59]

8.48 The Queensland stamp duty issues relating to the variation of a discretionary trust applies in these circumstances as well.

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[57] The recent case of *Benaroon Pty Ltd v Larmar & Ors* [2018] QSC 274 emphasises the difficulty in proving such a mistake at paragraph 8 by referencing *Public Trustee v Smith* [2008] NSWSC 397 in that "*…there must be clear and convincing evidence that at the time the trust deed was executed the trustee and the settlor had an actual intention as to the effect which the deed was intended to create which was different from the effect which the instrument did have in a clearly identified way…It must be demonstrated with clarity that the parties had a sufficiently precise intention that the court can determine both the substance and the detail of the precise variation to be made to the wording of the instrument…*"

[58] This emphasises the importance of properly analysing the potential beneficiaries of a discretionary trust and ensuring any change of the beneficiaries considers all 'types' of beneficiaries

[59] Section 104-25 *Income Tax Assessment Act 1997* (Cth)

8.49 Finally, where structuring the beneficiaries of a discretionary trust is not appropriate (whether due to potential adverse income tax or stamp duty consequences, or such change being uncommercial as relevant family members are unable to benefit from the trust), thought may be given in analysing the actual taxable wages.

8.50 A large consequence of having businesses grouped is the aggregation of taxable wages.

8.51 If potential grouping is a concern, then an ongoing analysis should be undertaken of taxable payments by all businesses within a potential group. If wages remain below the tax-free threshold then grouping may not need to be considered in detail. However if it looks as though a risk is materialising it might be at that point in time a review is undertaken and/or steps are taken to seek exclusion orders.

8.52 While a detailed explanation of what constitutes taxable wages for payroll tax falls outside the scope of this paper, below are examples when wages are excluded from being accounted:

(a) where wages made to employees are exempt;[60]

(b) where certain contractor exemptions could apply to some payments made to contractors;[61]

(c) where the business has evolved such that it no longer engages others for services, but rather seeks to provide services to others.[62]

9 Conclusion

9.1 The grouping provisions of the payroll tax legislation are intended to be broad.

9.2 Unfortunately, the broadness when combined with family businesses who have discretionary trusts in their group, results in businesses controlled by different family members being grouped.

9.3 Despite this, there are strategies available to segregate each family members' businesses, whether by applying for the revenue authority to exercise their discretion or taking internal steps to structure the businesses (and related family structures) correctly.

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[60] Section 14A *Payroll Tax Act 1971* (QLD)
[61] Section 13B(2) *Payroll Tax Act 1971* (QLD)
[62] *The Commissioner of State Revenue v The Optical Superstore* [2018] VSC 524

9.4 The trick is that it is harder than it may initially seem, and specialist advice should be sought to identify the most appropriate solution.

10 Acknowledgement

10.1 The author acknowledges the assistance of Lyndon Garbutt, Principal of West Garbutt in providing technical feedback for this paper but notes any errors are the author's own.

11 Disclaimer

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