

**TRUST LOSSES – COMMISSIONER LOSES HIS WAY**  
*Commissioner of Taxation v Clark* [2011] FCAFC 5

**John Balazs, Partner**  
**Balazs Lazanas & Welch LLP**

At its heart, this is a simple case about the existence of trust losses and their availability to offset capital gains made when ownership and control of the trust (the “Carringbush Unit Trust” (the **Trust**)) had completely altered.

Unusually, in view of the facts and the other options open to the Commissioner of Taxation (the **Commissioner**), the case was fought on general principles – (i) had the taxpayers discharged the onus of proof as regards the existence of the capital losses and (ii) was there continuity of the trust estate?

## **Background**

### **1 The Losses**

The Trust claimed to have made capital losses as follows:

- In 1991: \$375,995 in relation to a loan to Relsun Pty Limited (the **Relsun Loss**).
- In 1992: \$72,000 in relation to shares in Carringbush Kumagai Limited (the **CKL Loss**).
- In 1993: \$2,492,654.50 in relation to shares in Rothwells Limited (the **Rothwells Loss**).

In the period when the losses were made, the Trust was effectively owned and controlled by the Denoon family.

In late June 1993, the Clark family took up a 50% interest in the Trust and agreed to inject \$1.8m. The Denoon family (now owning all of the other 50%) agreed to inject a similar amount, but, failing that, the Clark family could acquire the Denoon family’s interest for \$5.

By 30 June 1993 the Clark family had injected the \$1.8m plus an additional \$165,000 (on paid as consulting fees to a company associated with Mr Denoon).

By August 1994 it was made clear that the Denoon family would not be able to contribute its \$1.8m and that led to their 5 units being transferred to the Clark family for \$5, although it was not until 26 April 1996 that the units were formally transferred.

As part of the arrangement:

- 1 The original trustee, Carringbush Pty Limited (**Carringbush**), was replaced as trustee by Clark Enterprises Pty Limited (**CEPL**).
- 2 Carringbush waived its right to be indemnified.
- 3 CEPL was effectively released and indemnified in respect of any liabilities owed with respect to the period when the Denoon family controlled the Trust.

### **2 The Capital Gains**

In 1997, CEPL acquired two properties and those properties were sold in the 2001 income year. The sales resulted in capital gains of \$1,932,006.

CEPL applied the capital losses against the capital gains so that for the 2001 income year there was no net capital gain.

### **3 Tax**

Notwithstanding the position regarding capital gains and losses, the Trust had income and the income of the Trust was distributed to a unit holder, DCE Holdings Pty Limited (**DCE**). DCE was entitled to the income as trustee of the David Clark Family Trust. DCE in turn distributed all of the income of the David Clark Family Trust to David Clark Enterprises Pty Limited as trustee of the David Clark Enterprises Trust. David Clark Enterprises Pty Limited as trustee of the David Clark Enterprises Trust distributed all its income to Mr and Mrs Clark.

It was as beneficiaries of the David Clark Enterprises Trust that the Commissioner sought to tax Mr and Mrs Clark on the capital gains made by CEPL.

The Commissioner challenged the existence of all the capital losses. He also said that the capital gains had been made by what was, in effect, a different trust estate from the one that made the capital losses.

#### **The Judgments - At First Instance**

In a lengthy judgment at first instance [2009] FCA 1401, Greenwood J reached the following conclusions:

1 As regards the Rothwells Loss:

[32] In any event, the oral evidence of best recollection of a transaction that occurred 21 years ago, taken in conjunction with the entries in the financial statements and the entries in the share register, establish, on the balance of probabilities, that the Rothwells shares were acquired by Carringbush as trustee of the ... Trust in or about January or February 1988 or at least at a date within the second six months of the financial year ending 30 June 1988. The shares were sold in the 1993 income year giving rise to a net capital loss of \$2,492,653.50.

2 As regards the Relsun Loss:

[141] Since the financial accounts have been prepared by BDO Nelson Parkhill on the basis of access to the underlying documents, I accept that the entries in the financial accounts reflect an acquisition of the Relsun shares and a write-off of a loan to Relsun.

3 As regards the CKL Loss:

[143] In the absence of any evidence in contradiction, I accept that the entries in the financial accounts prepared by BDO Nelson Parkhill on the basis of access to the primary documents, reflect a true and fair view of the trust estate's investment in the CKL shares and that the investment became irrecoverable by reason of the liquidation of CKL on 2 October 1991.

4 There was continuity of the trust estate, so the capital losses could be applied against the capital gains.

#### **The Judgments - The Appeal**

The Commissioner challenged all of Greenwood J's conclusions.

## 1 **The Evidence**

In relation to the first three conclusions, the Commissioner challenged the conclusions on the basis that Greenwood J had made inferences that were not reasonably open on the facts and failed to give effect to section 14ZZO of the *Taxation Administration Act 1953*.

In effect, the Commissioner was arguing, as he had at first instance, that without the contemporaneous primary documentation, the taxpayers could not prove that the losses existed.

All three judges, Dowsett, Edmonds and Gordon JJ, rejected this.

The main focus was on the Rothwells shares, with the Commissioner arguing that the shares had not been acquired by Carringbush.

In that respect the Full Court recognised that the lack of contemporaneous documentation was due in part to the fact that the transactions regarding the acquisition of the Rothwells shares occurred more than 20 years ago, implying that the Commissioner's approach was clearly misguided (not to mention unfair and unreasonable).

The Full Court also took the view that, as the Commissioner made no attempt to show that someone other than Carringbush had paid for the Rothwells shares, the primary judge was entitled to rely on the evidence he relied on – essentially the financial statements of the Trust – for his finding that Carringbush had paid the amount recorded in the financial statement for the Rothwells shares.

## 2 **Continuity of the Trust Estate**

On this issue, the Full Court split.

Dowsett J dissented, concluding at [44] that *the trust estate which incurred the relevant losses was gone*.

His Honour relied (at [36]) on *FCT v Commercial Nominees of Australia Limited* [2001] HCA 33, seeing the following as the crucial passage of the High Court's judgment:

Changes in one or more of those matters [the constitution, the trust property and membership] must be such as to terminate the existence of the eligible entity, or to produce the result that it does not derive the income in question, to destroy the necessary continuity. (at [36])

In his Honour's view, the affairs of the Trust had effectively been wound up and there had been a fresh start when the Clarks invested in the Trust and where *a trust has been effectively deprived of all assets and re-endowed*, there is *no way in which it can be said that the original trust estate has continued* (at [45]). As his Honour so bluntly put it at [44]:

It cannot seriously be suggested that such gain was the product of any part of the trust estate held prior to, or at 18 June 1993, nor can it sensibly be argued that any part of that capital gain was produced by the \$10 settlement amount.

The majority, Edmond and Gordon JJ, rejected the Commissioner's argument that there had been "discontinuity" as regards the three main indicia – the constitution, the trust property and the membership. Essentially, their Honours said:

- 1 The waiver by Carringbush of its right to be indemnified was irrelevant. (at [82])
- 2 The contention that the arrangements between the Denoon family and the Clark family (separately documented) meant that the rights to income under the Trust ceased to be governed wholly by the trust deed was misconceived. Those arrangements did not vary or terminate the Trust or bring a new trust into existence. (at [83])
- 3 When the High Court in *Commercial Nominees* spoke of trust property and membership as providing two of the indicia of continuity, the High Court was not saying that there had to be *strict or even partial identity* of property or objects. (at [87])
- 4 *What is required is a continuum of property and membership, which could be identified at any time, even if different from time to time; and without severance of one or both leading to the termination of the trust in question it was not possible to contend on the evidence that there had been a severance in the continuum of trust property and objects. **Their identity changed from time to time, but not their continuum.*** (at [87]) (emphasis added)

In essence, the majority believed that the trust estate remained the same trust estate, notwithstanding the very tenuous connection between the circumstances in which the capital losses were made and those in which the gains were made.

### **Conclusion**

To have succeeded in acquiring and effectively utilising a loss trust places the Clarks in a very select group and, whilst many will be comforted by how scant the connection needs to be for there to be continuity of the trust estate, the more significant victory for taxpayers is with respect to the evidentiary issue.

The resolution of the evidentiary issue in favour of the Clarks will resonate with many taxpayers who are currently being subjected to scrutiny on events that took place, in some cases, back in the 1970s.

The Commissioner's current position, based on anecdotal evidence, is that in the absence of contemporaneous documents, transactions are likely to be shams and he can amend assessments because there has been fraud or evasion. In light of his failure in *Clark* on the evidentiary issues, the Commissioner needs to reconsider his approach on the standard of proof when the matters relate to issues that occurred long ago.

Whether the Commissioner will accept either outcome from the case remains to be seen. He may, of course, appeal.