Merchant and Commissioner of Taxation [2024] AATA 1102 -

Australian Government
Australian Taxation Office

Decision impact statement

Merchant and Commissioner of Taxation [2024] AATA 1102

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Venue:	Administrative Appeals Tribunal
Venue reference no:	2020/6932
Judgment date:	16 May 2024

Summary of decision

1. This Decision impact statement outlines the ATO's response to this case, which concerns a review by the Tribunal of the Commissioner's decision to disqualify Mr Merchant (the Applicant) under subsection 126A(2) of the *Superannuation Industry (Supervision) Act 1993* (SISA) from acting as a trustee or responsible officer of corporate trustees of superannuation entities.

2. All legislative references in this Decision impact statement are to the SISA, unless otherwise indicated.

3. All judgment references in this Decision impact statement are to the judgment of *Merchant and Commissioner of Taxation* [2024] AATA 1102, unless otherwise indicated.

Overview of facts

4. The Applicant co-founded a business that eventually became Billabong Limited (BBG), a listed company on the Australian Securities Exchange.[1]

5. Gordon Merchant No 2 Pty Ltd as trustee for the Merchant Family Trust (MFT), held various assets that included BBG shares and all shares in Plantic Technologies Ltd (Plantic). MFT is one entity in the Merchant Group[2] of entities and the Applicant was a beneficiary of the trust.[3]

6. Due to Plantic's ongoing funding requirements, from May 2014, if not earlier, the Applicant was considering selling Plantic. In June 2014, sale negotiations commenced with a third party, Sealed Air Corporation (Sealed Air).[4]

7. Ernst & Young (EY) was consulted about the structure of the sale. A substantial capital gain was anticipated in respect of the sale of Plantic. EY's advice as to the preferable structure of a future sale of Plantic was for[5]:

- MFT to sell its shares in Plantic, rather than Plantic selling its assets
- related entities in the Merchant Group to forgive loans they have made to Plantic to the sum of about $55 million (Plantic Loans), and
- GSM Superannuation Pty Ltd (GSMS) as trustee for the Gordon Merchant Superannuation Fund (GMSF) to acquire from the MFT a substantial number of the MFT's high cost shares in BBG with the result that the MFT would crystallise a significant capital loss.

8. The Applicant was, at relevant times, a director of GSMS and thereby a responsible officer of the corporate trustee of GMSF.[6]

9. On 15 March 2012, a resolution titled 'Investment Objectives & Strategy' (2012 ISD) was made by GSMS as trustee for the GMSF. Relevantly, the 2012 ISD provided that, to achieve the investment objectives of GMSF, the GSMF holdings in shares in listed companies was to comprise a range of 0-40% of GMSF's assets under management.[7]

10. For the year ended 30 June 2013, GMSF paid an annual pension of $470,500 to the Applicant.[8]

11. On 4 September 2014, the MFT sold 10,344,828 BBG shares to the GMSF for $5,844,827.82 (BBG Share Sale). The result was that the MFT crystallised a capital loss of $56,561,940.[9] This transaction reduced the cash reserves of GMSF to $1,868,241.18.[10]

12. The sale to Sealed Air did not eventuate[11] but on 15 October 2014, another third party, Kuraray Co Ltd (Kuraray) began steps to acquire Plantic. Negotiations with Kuraray were successful, and a Share Sale Agreement was entered into on 31 March 2015 (SSA) resulting in MFT selling all of its shares in Plantic to Kuraray.[12]

[1] At [7].
[2] The group of Australian corporate entities forming the Merchant Group are diagrammatically depicted at [8].
[3] At [9].
[4] At [11].
[5] At [11].
[6] At [12]. The Applicant was also the sole shareholder of GSMS.
[7] At [52].
[8] At [56].
[9] At [13].
[10] At [78].
[11] At [14].
[12] At [15].

13. On 2 April 2015, as a condition precedent to completion of the SSA, the Plantic Loans were forgiven by the Merchant Group lenders. Completion of the SSA occurred later that same day.[13]

14. The MFT's capital gain on the sale of its shares in Plantic to Kuraray was approximately $85 million. By reason of the BBG Share Sale, the MFT had capital losses sufficient to absorb the whole capital gain.[14]

15. At a meeting of the Merchant Group on 30 April 2015, cash flow issues in GMSF were discussed, including consideration as to whether a contribution would be made in the 2014–15 income year to fund the Applicant's pension and to cease the pension from 1 July 2015 to preserve cash reserves.[15] Minutes of a meeting of the directors of GSMS, held on 25 June 2015, record that the Applicant requested that GMSF, with effect from 1 July 2015, commute his existing account-based pension income stream and roll his account balance into accumulation mode.[16] Further, the financial statements and reports for GMSF for the year ended 30 June 2015 showed that the Applicant made a non-concessional contribution of $180,000 to GMSF. It was accepted by the Tribunal that, without the contribution, expenses would have exceeded the income of the GMSF in that year. The Tribunal also noted that the predominant expense in that year was payment of the Applicant's pension of $523,500.[17]

16. The BBG shares acquired by GMSF had ceased paying fully franked dividends after 24 October 2008 and no dividends had been declared since April 2012.[18]

17. The arrangements undertaken were considered by the Commissioner and as a result, determinations under Part IVA of the *Income Tax Assessment Act 1936* were issued by the Commissioner. See *Merchant v Commissioner of Taxation* [2024] FCA 498.

18. The Commissioner considered that the arrangements gave rise to contraventions under:

- subsection 34(1) for failing to ensure that the prescribed standards applicable to the operation of GMSF were complied with – in particular the investment strategy obligations outlined in regulation 4.09 of the *Superannuation Industry (Supervision) Regulations 1994* (SISR)
- subsection 62(1), as GMSF was not maintained for the sole purpose of providing retirement benefits, and
- subsection 65(1) as GMSF provided financial assistance to MFT that ultimately flowed to the Applicant.

19. As a result, the Commissioner as regulator made the decision to disqualify the Applicant from being a trustee of a superannuation fund under:

- subsection 126A(2), having formed the view that the nature or seriousness of these contraventions provided grounds for the Applicant's disqualification, and
- subsection 126A(3), on the basis that the Applicant was not a fit and proper person to be a trustee, or responsible officer of a body corporate that is a trustee, of a superannuation fund.

[13] At [16].
[14] At [17].
[15] At [80].
[16] At [81].
[17] At [82].
[18] At [101].

20. At objection, the decision to disqualify the Applicant under subsection 126A(3) was set aside by the Commissioner.

Issues decided

21. The following issues were decided by the Tribunal.

1. Subsection 34(1) – investment strategy

22. The Tribunal confirmed that the SISA and SISR do not impose a direct requirement that a trustee must consider or reconsider each of the matters in paragraphs 4.09(2)(a) to (e) of the SISR when making a particular investment decision. Rather, in making each investment decision, the trustee must 'give effect' to the investment strategy which has been formulated having regard to the circumstances of the entity, including the matters in paragraphs 4.09(2)(a) to (e), and review that strategy regularly.[19]

23. GSMS breached subsection 34(1) as it did not 'give effect to' the relevant investment strategy[20] for the following reasons:

- The predominant reason for GMSF's acquisition of the BBG shares was to crystallise a capital loss in the MFT (which was expected to make significant capital gains) and the Applicant had no genuine purpose of investing for the GMSF.[21]
- The Applicant did not turn his mind to any of the required relevant matters when making an investment, including the marketability of the asset, risks, liquidity requirements, GMSF's ability to discharge its liabilities, and whether GMSF should hold a contract of insurance.[22]
- The BBG Share Sale resulted in the 0-40% listed company holding limit in the 2012 ISD being exceeded and a lack of diversification.[23]
- The material before the Tribunal did not establish that financial advisers were consulted about the BBG Share Sale.[24]

2. Subsection 62(1) – sole purpose test

24. GSMS did not '"ensure that the fund [was] maintained solely" for one of the purposes in s 62(1)'.[25]

25. The predominant reason the Applicant, as director of GSMS, agreed to enter into the BBG Share Sale transaction was to crystallise a capital loss in the MFT which was expected to make significant capital gains from selling the Plantic shares. A substantial purpose (but not the predominant purpose) of GSMS was to keep ultimate beneficial or economic ownership of the BBG shares within the Merchant Group. Neither of these purposes was a core purpose within the meaning of subsection 62(1).[26]

[19] At [123].
[20] At [128].
[21] At [129].
[22] At [130].
[23] At [131].
[24] At [132].
[25] At [151].
[26] At [150].

3. Subsection 65(1) – financial assistance

26. There was a breach of subsection 65(1) as financial assistance was given to the Applicant, who was a discretionary object of the MFT. The BBG Share Sale was entered into for the predominant and immediate purpose of crystallising a capital loss in the MFT for the purpose of increasing the financial resources of the MFT for the benefit of the discretionary objects of the MFT, specifically the Applicant.[27]

27. The Tribunal confirmed that paragraph 65(1)(b) is not limited to financial assistance of a direct nature. It prohibits financial assistance via an intermediary, including via a discretionary trust.[28]

4. Subsection 126A(2) – disqualification of the Applicant

28. In the specific circumstances of this case, the Tribunal decided that the Commissioner's decision to disqualify the Applicant under subsection 126A(2) should be set aside.[29]

29. The Tribunal came to the conclusion that a risk of future non-compliance by the Applicant was unlikely[30] for the following reasons:

- The Tribunal agreed with the Commissioner that the Applicant was a fit and proper person.[31]
- The Applicant had given undertakings to the Tribunal[32] which were accepted as appropriate and reasonable, and mitigated the risk of future non-compliance.[33]
- Although the Tribunal formed the view that the breaches of the SISA were serious, they all arose from a single course of conduct, being the BBG Share Sale. This was not a case of multiple breaches by the Applicant on multiple occasions.[34]
- The Tribunal did not place significant weight on protecting the investing public against the risk of re-offending. The Tribunal noted that the Applicant was only ever likely to be a director of the trustee of his own superannuation fund and did not believe that he required protecting from himself. Where he did, the Applicant's compliance with his undertakings would offer sufficient protection.[35]
- Although the breaches were serious, the circumstance that the offending transaction was one put forward by EY, which had acted both in the capacity of the Merchant Group's tax agent and also was GMSF's auditor, was a significant mitigating factor. EY had put forward the arrangement without raising an issue from a superannuation compliance perspective. While it was acknowledged by the Tribunal that EY advised that there were tax risks, that was a different issue to the issue of superannuation compliance. In those circumstances, the Tribunal accepted that the

[27] At [159].
[28] At [160].
[29] At [181].
[30] At [182].
[31] At [183]. The Commissioner's reasons for his conclusion that the Applicant was a fit and proper person for the purposes of subsection 126A(3) are summarised at [33].
[32] At [34].
[33] At [184].
[34] At [185].
[35] At [186].

Applicant would have fairly thought that the transaction was lawful from a superannuation compliance perspective.[36]

ATO view of this decision

30. The Tribunal's decision that there were serious breaches of subsections 34(1), 62(1) and 65(1) is consistent with our position.[37]

31. When considering all of the specific facts of this case, being the combination of each of the findings at paragraphs [183] to [187] of the decision, the Tribunal concluded that there was an unlikely risk of future non-compliance by the Applicant. This holistic consideration by the Tribunal of all of those particular facts is consistent with the Commissioner's approach as outlined in Law Administration Practice Statement PS LA 2006/17 *Self-managed superannuation funds – disqualification of individuals to prohibit them from acting as a trustee of a self-managed superannuation fund*.

32. That is, the Commissioner, when considering disqualification under subsection 126A(2), should consider:

- the acts of the individual
- all the facts of the case, and
- whether there is a future compliance risk.

33. The nature, number and seriousness of contraventions are questions of fact and degree, and it is not possible to apply prescriptive rules to the decision to disqualify.

34. An individual may be considered to be a future compliance risk if it is reasonable to draw that conclusion from their compliance history. This includes considering matters in relation to the management of their superannuation fund as well as their own personal tax affairs, or that of any other entity in which they have been in a position of responsibility.

35. Each case must be considered by us on its own individual circumstances. In doing so, we accept that mistakes can be made by trustees in the management of a fund's affairs. What is important is that the trustee demonstrates a willingness to comply with their obligations.

36. In this matter, the Commissioner had maintained that the nature, number and seriousness of contraventions by the Applicant were sufficient grounds for disqualification under subsection 126A(2). Further, as disqualification is designed to protect the investing public against the risk that people with a history of non-compliance will re-offend, the Commissioner had considered it reasonable to conclude that the Applicant posed a future compliance risk given the serious contraventions of the SISA.

37. However, we accept that, when considering the Tribunal's holistic consideration of all the particular facts as they applied to the Applicant, the decision that the Applicant was unlikely to be a future compliance risk and setting aside the disqualification of the Applicant, was reasonably available to the Tribunal on the facts before it.

38. As each case must be decided on its particular circumstances, we take the view that this decision has limited broader application beyond the 'peculiar circumstances of this

[36] At [183] and [187].

[37] As outlined in the Commissioner's public advice and guidance, including principles outlined in SMSFR 2008/1 *Self Managed Superannuation Funds: giving financial assistance using the resources of a self managed superannuation fund to a member or relative of a member that is prohibited for the purposes of paragraph 65(1)(b) of the Superannuation Industry (Supervision) Act 1993* and SMSFR 2008/2 *Self Managed Superannuation Funds: the application of the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993 to the provision of benefits other than retirement, employment termination or death benefits*.

case'.[38] As noted in paragraph 31 of this Decision impact statement, the approach taken by the Tribunal to the issues in this matter is consistent with the principles outlined in PS LA 2006/17. Furthermore, the decision does not displace the long-standing principle that the primary responsibility for operating a self-managed super fund rests with the individual trustees or the directors of the corporate trustee[39] nor restricts other consequences of contravening a civil penalty provision.[40]

39. We also note the decision in *Coronica and Commissioner of Taxation* [2024] AATA 2592 which was handed down by the Tribunal on 19 July 2024. In that decision, the Tribunal applied the same factors considered in this case to Mr Coronica's circumstances. Contrasting significant differences between the facts of this case and those of Mr Coronica, the Tribunal arrived at a different outcome, affirming the Commissioner's original trustee disqualification decision.

Comments

40. We invite you to advise us if you feel this decision has consequences we have not identified. Please forward your comments to the contact officer.

Due date: 4 October 2024

Contact officer details have been removed as the comments period has ended.

Commissioner of Taxation
4 September 2024

[38] At [188].
[39] See *Raelene Vivian, suing in her capacity as the Deputy Commissioner of Taxation (Superannuation) v Fitzgeralds* [2007] FCA 1602 at [21] per Logan J; *Fitzmaurice and Commissioner of Taxation* [2019] AATA 2217 at [36] per Deputy President Britten-Jones.
[40] See, for example, sections 196 and 202.

References

Legislative references:

- SISA 1993 34(1)
- SISA 1993 62(1)
- SISA 1993 65(1)
- SISA 1993 126A(2)
- SISA 1993 126A(3)
- SISR 1994 4.09
- ITAA 1936 Pt IVA

Cases relied on:

- Coronica and Commissioner of Taxation [2024] AATA 2592
- Raelene Vivian, suing in her capacity as the Deputy Commissioner of Taxation (Superannuation) v Fitzgeralds [2007] FCA 1602; 2007 ATC 5105; 69 ATR 834
- Merchant v Commissioner of Taxation [2024] FCA 498; 2024 ATC 20-909
- Fitzmaurice and Commissioner of Taxation [2019] AATA 2217; 110 ATR 440; 165 ALD 400; [2021] ALMD 2120; [2021] ALMD 2119

Other references:

PS LA 2006/17

SMSFR 2008/1

SMSFR 2008/2

ATO references

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