

Tax Alert

Yazbek, beneficiaries and extended assessment periods

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Who is a beneficiary of a discretionary trust for income tax purposes? The Federal Court answered this question in the recent decision in *Yazbek v Commissioner of Taxation* [2013] FCA 39 ("**Yazbek**"). The case centred on whether the Commissioner was out of time in issuing an amended assessment to the taxpayer. Under the relevant provisions of the *Income Tax Assessment Act 1936* ("**ITAA36**"), the Commissioner would not be out of time if the taxpayer was a beneficiary of a trust estate at any time during the year in question. The Court held that the taxpayer was a beneficiary, despite the fact that he had not been made presently entitled to any income of the trust.

This means that a person who has a contingent entitlement to any distribution under a discretionary trust will nevertheless face a potential re-assessment of their income tax up to 4 years after the relevant year.

This decision will come as a surprise to many advisers who have taken the view that any clients with simple tax affairs should only be subject to a 2 year amendment period. It will usually be the case that most clients will have a contingent interest in some trust somewhere.

Facts

Mr Lewis Yazbek was a member of a class of persons who could benefit under a trust estate known as the Lewis Yazbek Family Settlement ("**Trust**"). Being a discretionary trust, Mr Yazbek would only be presently entitled to income from the Trust upon an exercise of the trustee's discretion to make a distribution in his favour. The other potential objects of the Trust were members of Mr Yazbek's extended family, and totalled some 129 individuals.

Mr Yazbek received no income from the Trust, and reported having received nil income in his income tax return. Of the Trust's distributable income, \$60,000 was

allocated to his wife, and the remainder to a company, Rocbit Pty Limited.

The Commissioner issued a Notice of Assessment to Mr Yazbek on 18 April 2006 in respect of the 2005 income year. On 12 April 2010, just shy of 4 years later, the Commissioner issued an amended assessment for an additional amount of \$2,144,843.

Mr Yazbek appealed to the Administrative Appeals Tribunal. The Tribunal decided, in *Yazbek and Commissioner of Taxation* [2012] AATA 477 ("**Tribunal Decision**"), that Mr Yazbek was a beneficiary of the Trust for the purposes of the ITAA36, and therefore, that the Commissioner did have the power to issue the amended assessment. Mr Yazbek appealed that decision to the Federal Court.

Statutory provisions

Section 170(1) of the ITAA36 allows the Commissioner to amend an individual's assessment within 2 years after the day on which the original assessment was issued, unless the individual is a beneficiary of a trust estate at any time during that year, in which case the Commissioner may re-assess within 4 years (Items 1 and 4). There are similar provisions which set out the time limits that apply to taxpayers who are small business entities and trustees (see Items 2 and 3).

If the individual is a beneficiary, but the trust is a small business entity for that year, or the trustee of the trust (in that capacity) is a full self-assessment taxpayer for that year, then the time limit on re-assessment is two years.

The definition of a "beneficiary"

Mr Yazbek contended that he was not a "beneficiary" within the meaning of the ITAA36. He relied on the

definition of “beneficiary” in the LexisNexis *Encyclopaedic Australian Legal Dictionary*, which stated that it was a misnomer to describe objects of a discretionary trust as “beneficiaries” as they have no beneficial interest in the assets of the trust.

The Court instead found that “beneficiary” takes its meaning from the case law, and that a beneficiary for the purposes of the ITAA36 “includes a person who is the object of a discretionary trust, including a person who has received no income or benefit from the trust in a given year.”

The Court relied primarily on the Federal Court decision in *Kafataris v The Deputy Commissioner of Taxation* [2008] FCA 1454. The Court cited various statements of law which are set out in *Kafataris*, and which can be summarised as follows:

- The expression “beneficiary” is not defined in the tax law and bears its ordinary meaning.
- A beneficiary is any person for whose benefit a trust is to be administered, and who is entitled to enforce the trustee’s obligation to administer the trust according to its terms.
- A person does not need to have a beneficial interest in the trust property in order to be a “beneficiary”. A trustee can hold the legal title to trust property, and owe fiduciary obligations in respect of that trust property to “beneficiaries”, without those beneficiaries having any beneficial interest in that property.

Statutory interpretation of the relevant provisions

Mr Yazbek also appealed the AAT’s decision on the basis of the proper construction of section 170, and the effect that the section would have if the Commissioner’s position were upheld.

The Court held that qualification (d) in section 170(1) described the status of a person, and did not deal with some activity or circumstance that occurred while a person held that status. In other words, it was enough that a person was a beneficiary; they did not need to receive, as a beneficiary, a distribution from a trust.

Mr Yazbek also argued that, if the Commissioner’s

interpretation of section 170(1) were to succeed, it would result in “arbitrary and capricious, if not haphazard and gratuitous” assessments, by giving the Commissioner extra time to locate a trust of which a taxpayer is a potential beneficiary. The Court did not accept this argument, and cited the High Court decision in *Commissioner of Taxation v Ryan* (2000) 201 CLR 109 in saying that “appeals to notions of “fairness” or “justice” usually mean that the conclusion asserted has no foundation in the legislation”, and that the risk to the taxpayer was that they would have to pay amounts lawfully due under the statute.

The Court also held that, in the context of the section, the ITAA36 and the extrinsic materials, there was no reason to qualify the use of the word “beneficiary” in section 170(1) to apply only to beneficiaries who are presently entitled or receive distributions in an income year.

Impact

This decision means that section 170(1) operates as a blanket provision, to allow the Commissioner to issue amended assessments to beneficiaries, regardless of their entitlements to trust distributions. This raises obvious conflicts with other provisions of the tax law under which assessments could be made, given that liability for tax on trust income is generally calculated on the basis of a present entitlement.

It also means that advisers must now be vigilant in advising their clients when it comes to the periods in which the ATO can issue amended assessments. On the upside, it could also allow taxpayers who would have been prevented from seeking amendments to their assessments to have the benefit of a further period of 2 years.

Written by:

Arthur Athanasiou

Partner

+61 3 8080 3563

aathanasiou@thomsonslawyers.com.au

Mark Gioskos

Lawyer

+61 3 8080 3657

mgioskos@thomsonslawyers.com.au

Paul Tanti

Partner

+61 8 8236 1327

ptanti@thomsonslawyers.com.au

Philip de Haan

Partner

+61 2 9020 5703

pdehaan@thomsonslawyers.com.au

For further information, please contact our national **Tax** team.

www.thomsonslawyers.com.au