

When is a benefit from a trust not a fringe benefit? When it's an "ownership" benefit



When a corporate trustee of a trust provides a benefit to a director who is a beneficiary of the trust, it can sometimes be difficult to determine in what capacity that benefit is received. For example, where a corporate trustee of a trust owns and operates a business, the director of the corporate trustee works in the business, the director is a beneficiary of the trust and the director receives a benefit from the trust, does the director receive that benefit in their capacity as an employee, a director, a beneficiary or as an "owner"?

This can be important where that benefit provided to a director is potentially a fringe benefit that is subject to fringe benefits tax (FBT) under the *Fringe Benefits Tax Assessment Act 1986* (FBTAA).

WHEN WILL A BENEFIT TO A DIRECTOR/BENEFICIARY POTENTIALLY BE A FRINGE BENEFIT?

Under s 136(1) FBTAA a "fringe benefit" will arise where a benefit is provided:

- to an employee, an associate of an employee or some other person at the direction of an employee or an associate of an employee;
- by the employee's employer or an associate of the employer or by a third party under an arrangement with the employer or with an associate of the employer; and
- in respect of the employment of the employee.

The key questions will therefore be whether the director is an employee and whether the benefit is provided in respect of employment.

IS A DIRECTOR AN EMPLOYEE?

Determining whether a director is an employee for the purposes of FBTAA is a rather convoluted exercise:

- section 136(1) FBTAA defines an **employee** to mean a current employee, a future employee or a former employee;
- a **current employee** is defined in s 136(1) FBTAA to mean a person who receives, or is entitled to receive salary or wages;
- under s 136(1) FBTAA **salary or wages** includes a payment from which an amount must be withheld under schedule 1 to the *Taxation Administration Act 1953* (ie subject to PAYG withholding) to the extent the payment is assessable income;
- in addition under s 137 FBTAA it is relevant in ascertaining whether a person is an employee where a benefit is received by a person and if that benefit was provided by way of cash it would constitute salary or wages;
- **employment** is defined under s 136(1) FBTAA as the holding of any office or appointment, the performance of any functions or duties, the engaging in of any work, or the doing of any acts or things that results, will result, or has resulted in the person being treated as an employee.

At common law a director is generally not treated as an employee of a company.¹ However under FBTAA a director will be a "current employee" if they are paid in the course of holding the position of a director as they will be deemed to receive "salary or wages".² A director may still be deemed

to be an employee under FBTAA where they are not paid any amounts if they receive a benefit that if provided by way of cash would constitute salary or wages. Even if a director receives no payments or benefits they may still be deemed to be in employment under FBTAA by the mere holding of the office of a director.

It is therefore likely that in most cases a director of a corporate trustee will be deemed to be an employee of the trust under FBTAA.

IS A BENEFIT PROVIDED IN RESPECT OF EMPLOYMENT?

The principal authority³ on the definition of the phrase "in respect of employment" is the Full Federal Court decision of *J & G Knowles & Associates Pty Ltd v Commissioner of Taxation*⁴ (**Knowles**).

Knowles involved the provision of loans by a corporate trustee of a unit trust to its directors. The units in the unit trust were held in equal shares by four discretionary trusts established by each of the four directors of the trustee for the benefit of their families. Each director was the trustee and a beneficiary of the family discretionary trust.

The corporate trustee maintained a cheque account that all directors were authorised to operate. The directors drew on funds in the account to meet their private expenses. There was no relationship between the amounts of money drawn and the personal effort involved in working as a director, nor between the amounts paid to the different directors. The amounts were transferred to loan accounts in the name of family discretionary trusts and treated as loans to the directors in the unit trust's

accounts. In addition the directors were paid modest salaries.

The issue before the Full Federal Court was whether the loans made to the directors were “in respect of” their employment as directors or as indirect owners (through the unit holding discretionary trusts established for their benefit and their family’s benefit).

The matter was appealed to the Full Federal Court after the Administrative Appeals Tribunal (AAT) found that as there was a causal connection between the loan benefits and employment, the loans constituted a fringe benefit paid in respect of employment.

was a sufficient or material connection. Therefore the matter was returned to the AAT for reconsideration.

As a result of Knowles the mere provision of a benefit to a director of a corporate trustee will not trigger FBT. This may be so even if (as is often the case for “family” trusts) there is a provision of a benefit to a director that can be attributed to both their “employment” and as a beneficiary/”owner” of that trust. It is important to look at the surrounding factors relating to the payment of the benefit to determine whether it is provided in respect of employment.



the mere provision of a benefit to a director of a corporate trustee will not trigger FBT



When considering whether a benefit will be made in respect of employment the Full Federal Court stated:⁵

“...the phrase (in respect of the employment) requires a “nexus, some discernible and rational link between the benefit and employment”... What is required is a sufficient link between the purposes of the particular legislation... It cannot be said that any causal relationship between the benefit and the employment is a sufficient link so as to result in a taxable transaction. For example, a discretionary trust with a corporate trustee might be established to purchase a family home for the benefit of its directors and their family. It does not follow that the rent free occupation of that home on the authority of the directors is a benefit provided “in respect of” their employment for the purposes of the Act. While there is a causal relationship between the provision of the benefit and the employment it is not a sufficient or material relationship. The rent free occupancy arises because the trust was established for that purpose; a reason extraneous to the employment of the directors...”

The Full Federal Court held that there must be a sufficient or material rather than a mere causal connection or relationship between the benefit and the employment. A causal connection was established but the AAT failed to determine whether there

WHAT FACTORS WILL BE CONSIDERED WHEN DECIDING WHETHER A BENEFIT PAID FROM A TRUST TO A DIRECTOR/ BENEFICIARY IS A FRINGE BENEFIT?

Factors that suggest a benefit is not a fringe benefit include:

- the benefit was made to the director because ultimately the trust was established, and its assets were to be held and applied, for the benefit of the director and that of their family;⁶
- the director is only performing nominal duties for the trust;⁷
- the director is being charged for the benefit (for example the director pays the trust rent for the use of a room in the trust’s business premises);⁸
- the “benefit” is the repayment of a loan as the product or incident of a creditor/ debtor relationship;⁹
- the benefit is an effective distribution of trust income for income tax purposes made to or for the benefit of the director as a beneficiary;¹⁰ and
- the director uses their own funds to improve the subject of the benefit.¹¹

Factors that suggest a benefit is a fringe benefit include:

- the benefit is specifically included in the director’s remuneration package or employment contract;¹²
- the provision of a similar benefit has been made to an “arm’s length” employee of the trust;¹³
- the benefit is of a kind more readily seen as employment related, eg private use of a business vehicle;¹⁴
- a reference is made in a director’s minute, to the provision of the benefit being in an employment context;¹⁵
- the benefit is provided as an incident of the director’s directorship;¹⁶
- the trust claims an income tax deduction for the expenditure on the benefit;¹⁷
- the value of benefit provided to the director varied in line with their services provided to the trust;¹⁸ and
- the director was underpaid for services rendered to the trust.¹⁹

CONCLUSION

Where a corporate trustee of a trust operates a business, the directors of that corporate trustee are beneficiaries of that trust and the directors work in the business; careful consideration must be undertaken before any benefits are provided to a director.

Any potential fringe benefit that is provided to a director in respect of their employment rather than as beneficiary of the trust could potentially trigger FBT.

To that end it is important that firstly the reasons for providing any potential fringe benefit from the trustee of a trust to a director in their capacity as a beneficiary of that trust are properly documented and secondly to ensure that the surrounding circumstances for the provision of the benefit do not suggest the benefit was provided in respect of employment.

*Philip Broderick ATIA
Senior Associate
Harwood Andrews Lawyers*

Reference notes:

- 1 *Normandy v Ind. Coope & Co Ltd (1908) 1 Ch 84 and Re Lee, Behrens & Co Ltd (1932) 2 Ch 46*
- 2 See s 136(1) FBTA and ss 12-40 and 12-45 of schedule 1 to the Taxation Administration Act 1953
- 3 Further authority includes the cases of *Starrim Pty Ltd v Commissioner of Taxation [2000] FCA 952*, *Slade Bloodstock Pty Ltd v FC of T 2007 ATC 5276* and *Case 28/97 97 ATC 321*. See also the Commissioner's pre-Knowles view in *Miscellaneous Tax Ruling MT 2019* especially at para 6 where he states that "if however, it can be established that a benefit is provided to a shareholder/employee solely by reason of that person's position as a shareholder of the company and not to any extent by reason of that person's employment by the company, the benefit will not be subject to FBT." The ruling confirms that not all benefits to employees who are shareholders/beneficiaries will be in respect of employment however in light of Knowles it is clear that a benefit does not have to be provided solely by reason of a position of a shareholder/beneficiary for that benefit not to be in respect of employment.
- 4 2000 ATC 4151
- 5 At para 23
- 6 See Knowles para 30
- 7 See *Miscellaneous Tax Ruling MT 2019* para 12
- 8 See *Miscellaneous Tax Ruling MT 2019* para 12
- 9 See *Slade Bloodstock Pty Ltd v FC of T 2007 ATC 5276* – of particular note is para 10 where the Full Federal Court stated that "Fringe Benefits Tax was only intended to tax the provision of benefits where, if the benefit had been provided in cash, there would have been a derivation of income...it was never intended to apply to a repayment of a loan... such a repayment could never be a derivation of income by the lender/employee."
- 10 See *Miscellaneous Tax Ruling MT 2019* para 22
- 11 See *Case 28/97 97 ATC 321* where a relevant factor for the tribunal in finding that the use by the director of a house held by a trust included that the director used her own funds to improve the house.
- 12 See *Tax Determination TD 94/D31 (Withdrawn 30 August 1995)* para 2
- 13 See *Tax Determination TD 94/D31 (Withdrawn 30 August 1995)* para 2
- 14 See *Tax Determination TD 94/D31 (Withdrawn 30 August 1995)* para 2
- 15 See *Tax Determination TD 94/D31 (Withdrawn 30 August 1995)* para 2
- 16 See Knowles para 33
- 17 See *Miscellaneous Tax Ruling MT 2019* para 10
- 18 See *Miscellaneous Tax Ruling MT 2019* para 16
- 19 However see *Starrim Pty Ltd v Commissioner of Taxation [2000] FCA 952* where the Court found that the fact that directors are paid a low level of income does not inevitably result in a benefit being in relation to employment and that there must be a sufficient relationship between the employment and the provision of the benefit.