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[516] The Slade Bloodstock case - a disturbing decision
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Any person acting in the position of a director, office holder, employee and shareholder of a company, especially in an SME, should be following with concern the decisions in the AAT (in *AAT Case [2006] AATA 666, Re Slade Bloodstock Pty Ltd and FCT* (31 July 2006), reported at 2006 WTb 33 [1422], and the successful appeal against that decision by the Commissioner in the Federal Court in *FCT v Slade Bloodstock Pty Ltd* [2007] FCA 188 (23 February 2007), reported at 2007 WTb 9 [364].

Background

In the AAT case, the Applicant was Slade Bloodstock Pty Ltd (Slade Bloodstock), which acted as a trustee of the Slade Bloodstock Unit Trust. Slade Bloodstock was in the business of purchasing race horses at yearling sales, and then forming syndicated partnerships for potential investors in respect of each horse.

Like many SMEs in start-up circumstances, Slade Bloodstock had become dependent upon capital contributions of cash funding made by Mr and Mrs Slade (Robert and Corinna), who were the effective shareholders, directors and sole employees of Slade Bloodstock. Substantial credit loan balances for employees, directors and shareholders of \$14,618, \$67,272 up to \$94,506 had been accumulated for Mr and Mrs Slade over financial years ended 30 June 2001, 2002 and 2003.

Periodically, they would draw down on those credit balances, and the balances would be debited accordingly with the amount drawn down. Those loan draw downs were treated by Slade Bloodstock as repayments of loan and not as fringe benefits for accounting and taxation purposes.

In 2003, the Commissioner audited Slade Bloodstock and disagreed with that treatment by the company. According to the Commissioner, the drawings from the bank account by Mr and Mrs Slade should have been treated simply as fringe benefits, to which the FBT provisions would apply, upon which FBT was fully payable and for which FBT returns should have been lodged.

The Commissioner then issued default assessments pursuant to s 73 of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) of \$22,605.36 for the FBT year ended 31 March 2000,

\$15,853.68 for the year ended 31 March 2001 and \$20,231.77 for the year ended 31 March 2002. After allowing for deductibility (ie fringe benefits would be deductible to Stock Bloodstock, but loan repayments would not), the Commissioner imposed penalties of 50% under s 114 of the FBTA, for "recklessness" on the part of Slade Bloodstock.

FBT taxable values

In determining the taxable amounts of FBT and the FBT payable, the Commissioner appears to have simply taken the amounts of draw down and applied FBT, without consideration as to the type of fringe benefit (eg expense payment, property, residual fringe benefit etc) and then simply applied the rate to the total aggregated FBT amounts.

The Commissioner also failed to account for any consideration that may have been provided as a "recipients contribution" that could reduce the FBT taxable values to zero.

The contentions of the taxpayers

Slade Bloodstock contended that the payments drawn by Mr and Mrs Slade did not relate to the employee relationship, but were simply a repayment discharged by Slade Bloodstock of its loan obligations undertaken in earlier years, as a debtor, to Mr and Mrs Slade.

The applicant further contended that, to the extent that the payments were a "fringe benefit", neither Robert nor Corinna Slade were employees, as defined in the Act. The AAT Member, Dr Gordon Hughes (at 41), was of the view that what had started out as a "hobby or a passion" had evolved into a viable business, in which Mr and Mrs Slade had full-time employment relationships.

Dr Hughes conceded that, while there was a "superficial attraction" (at 49), in concluding that the payments were in respect of employment, this was in fact not the case, and the payments at all times were accounted for by the recipients themselves (ie Robert and Corinna) and the provider Slade Bloodstock (ie the applicant), as nothing more than loan repayments.

Dr Hughes went on to point out that, as lenders of monies to Slade Bloodstock, Robert and Corinna would have been entitled to the repayments of the loan, regardless of the existence of the employment relationship, and payments could have been activated regardless of the existence of the employment relationship (at 49).

Dr Hughes concluded that there was no "material" relationship between the employment of Robert and Corinna and the provision of the benefit.

The Commissioner's appeal

The Commissioner subsequently appealed to the Federal Court, with the decision in that appeal being handed down by Heerey J.

Heerey J appears to have had little difficulty in overruling the decision of the AAT. He found that:

- Mr and Mrs Slade had been in receipt of a "benefit" as defined in s 136(1) of the FBTA, and that the benefit was provided in respect of the employment of them; and
- the shareholders loan agreement explicitly contemplated that Robert and Corinna would have their loans to Slade Bloodstock repaid by the discharge of their own personal obligations such as mortgages and school fees.

Heerey J (at 18) found that, unlike the ruling in *J & G Knowles & Associates Pty Limited v FCT* (2000) 44 ATR 22, there was something more than a mere causal relationship between the employment and the payment. He attributed the loan repayments to being in respect of employment (at 17), because "there were no other employees" and "the business could not have operated without their work" as employees.

Further, the discharge of the debts owed to Mr and Mrs Slade were as "discharge of their own personal obligations such as mortgages and school fees". Heerey J went on to observe that Mr and Mrs Slade were not;

"...employees who just happened to get repayments of a loan, their positions maybe contrasted with the hypothetical example of an employee of a large public company, who invests in publicly listed debentures of a company, which are in due course repaid." (at 18)

Heerey J said (at 18), that, "in such a case, the repayment would have nothing to do with the employment". Therefore, Heerey J concluded that the Commissioner's appeal should be allowed.

Owners/employees typically underpay themselves

Unlike directors of large public companies, directors, shareholders and employees of small private companies quite often provide substantial amounts of loan funding to their employer company. This is usually to ensure the survival of these companies, especially during the early years of their trading history.

Owners of SMEs, typically, underpay themselves and retain moneys in the business, to support that business.

It was for this very reason, in the context of superannuation, that the Government introduced the Transitional Reasonable Benefits Limits to extend the levels of superannuation contributions that could be made in respect of "associates" (ie owners/employees), based on the Commissioner's assessment of a reasonable "arm's length salary".

Comments

I doubt that a repayment by an employer of a loan from an employee can ever be regarded as a fringe benefit. With due respect to all concerned, this decision appears clearly wrong. As stated by Robin Speed in his article at 2007 WTB 10 [382], the reasoning is "unsound".

However, the problems with this case are compounded by the inadequate analysis of the FBT taxable values determined by the Commissioner. There seems to be a total disregard of the

consideration paid by the employee, which would constitute a "recipients contribution", capable of reducing the FBT taxable value to zero.

In the Tribunal, because Dr Gordon finds (ie correctly in my view) that there were no fringe benefits provided by the repayment of loans to Mr and Mrs Slade, therefore, there were no requirements upon the Commissioner to justify the taxable values of the "fringe benefits".

In the Federal Court, Heerey J (at 3) ruled somewhat more problematically that the only issue to be considered was whether the Commissioner has shown that the Tribunal has made an error of law in concluding that the repayments were not "in respect of the employment of an employee" within the meaning of s 5B and liable to tax under section 66 (1) of the FBTA.

Consideration paid

Of course, what is missing from these analyses in the AAT and Federal Court decisions is an investigation into how the taxable values of the possible fringe benefits are determined, taking into effect the fact that both Mr and Mrs Slade have paid consideration for any fringe benefits provided, which should reduce the prima-facie taxable value to nil. The consideration, of course, being the payment actioned by the debiting and reduction of the credit loan balances for Mr and Mrs Slade. As ruled in the Federal Court, payment includes the passing of a benefit in discharge of an obligation (refer *Temples Wholesale Flower Supplies Pty Ltd v FCT* (1990) 21 ATR 556).

Recipients contribution

The term "recipients contribution" is defined in s 136(1) of the FBTA as meaning the amount of consideration paid to the provider or to the employer, or by the employee, in respect of the provision of the benefit. The process of debiting the appropriate amounts against the outstanding credit loan balances of Mr and Mrs Slade, and reducing those balances, clearly constitutes the "recipients contribution" necessary to reduce any FBT taxable values. That is, payment and a provision of consideration by those employees to the company, in respect of the provision of the relevant fringe benefits (ie assuming that those benefits have been provided in respect of employment - which is doubtful).

Simply, the circumstances were such that the employees were not being provided with fringe benefits. They were merely being repaid amounts of loans owing to them.

However, If there were fringe benefits provided, those fringe benefits possess no intrinsic FBT taxable values, as they were simply loan repayments reducing outstanding credit loan balances.

Conclusion

With respect, this decision is clearly incorrect and disturbing at a number of levels.

As the taxpayer has appealed to the Full Federal Court, it maybe expedient for the company to focus not solely on whether a fringe benefit has been provided under the arrangement. While that issue is paramount, if one assumes that fringe benefits have been provided (however unlikely), one should also consider:

- how the taxable values are determined; and
- whether the taxable values should be reduced or eliminated, by the relevant "recipients contributions" having been made by the employees, Mr and Mrs Slade.

It is disconcerting that there appears to be a complete lack of consideration and appreciation by the Commissioner of how small business operators run their businesses, make loans to support their businesses, effect loan repayments and, quite separately, remunerate themselves.

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