[¶919] Directors' duties and tax avoidance, 16 December 2016

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The latest decision in the long running legal stoush between the ATO and the Binetter family, probably best known as the co-founders of the successful Nudie juice brand, explores when directors can be liable for causing their company to engage in tax avoidance activities. The decision in *BCI Finances Pty Limited (in liq)* v *Binetter (No 4)* [2016] FCA 1351 is both instructive as to directors' duties and provides the ATO with another option to visit corporate tax liabilities onto the underlying controllers/owners.

Background

The Binetters are the descendants of two rags to riches refugee brothers from Slovakia who came to Australia in 1950. As the family accumulated wealth it looked to reduce its Australian tax exposure by accumulating interest on funds parked offshore. It appears that the main strategy by which this was achieved was utilising back-to-back loans whereby one Binetter company might advance funds as security to a foreign bank in return for a loan by the bank to a second Binetter company. Structured in this way the "loans" produced deductible interest payments for the second entity while "black money" accumulated offshore.

Although apparently going on for decades the ATO was only alerted to this practice upon the discovery of a file note on the lap top of Jersey Accountant Philip Egglishaw, seized in the raid on his Sheraton Towers suite in Melbourne in 2004, the event that sparked the Wickenby project. Since then, a battle has raged between the ATO and Binetters with high profile Tax Lawyer Michael Binetter leading the defence for the family. Most readers will be familiar with this in the form of the Rawson Finance Pty Ltd litigation which so far has produced at least nine judgments, the most significant of recent times vindicating the Binetters on the basis that there was no evidence of back-to-back loans in that case.

However, the BCI Finances litigation has thrown up a different result, primarily due to the evidence of Michael Binetter's sister-in-law (privy only to the impugned transactions because of the need for her Hebrew language skills). This evidence has led to damning findings by her Honour Gleeson J to the effect that not only had the family created sham documentation to hide the true nature of the dealings but that Michael had actually paid a banker $63,000 to destroy incriminating documentation. An episode that her Honour described as "disgraceful" demanding an explanation by Michael who, perhaps understandably, failed to return to Australia to give evidence, having sold up and moved to New York.

The decision in BCI Finances

BCI Finances is not a tax case. Assessments had already been raised against the company and the ATO had appointed liquidators. At issue was the liquidators' claims that the directors were in breach of their directors' duties in allowing the company to enter into the tax avoidance schemes involving the back-to-back loans. It was contended that in entering into these schemes the directors had exposed the company to financial risk, resulting in the denial of deductions, tax penalties and, ultimately, winding-up.

The relevant directors' duties as identified by her Honour were:

- to not permit the interests of the director to conflict with those of the company
- to not exercise directors' powers to obtain a private advantage, and
- to not exercise directors' powers in manner detrimental to the interests of the company.

In finding that these duties were breached a critical consideration was that the transactions provided no benefit to the company. While the proceeds of the "loans" were invested in other Binetter concerns the returns were netted off against the interest expense. Rather the primary design of the transactions was to allow funds to accumulate and earn income offshore for the benefit of other entities.

Nor was it an answer to allege that the duties were owed to the shareholders who had given their consent to the transactions. It is well established that directors' duties are owed to the company. In the performance of the duties this may require that various stakeholders interests be addressed not merely shareholders. In

particular, where the solvency of the company is at issue, the directors must address their attention to the interests of creditors. Furthermore, the doctrine of unanimous consent does note enable the shareholders to ratify conduct that amounts to a fraud on the creditors.

Although Michael Binetter was not a director of BCI Finances, her Honour was able to conclude that, given he had taken on such an active role in the company, he was viewed objectively a de facto director (within the meaning of s 9(b) of the *Corporations Act 2001*). Counsel for the Binetters had submitted that Michael was simply acting as the company solicitor but the evidence was that he had been held out as a director and conducted himself as such. In particular, he had been instrumental in procuring back-to-back loans, documenting the arrangements to suggest the desired outcome, lodging the relevant tax returns and then prosecuting the defence for the company once the ATO audits had begun.

Having found a breach of directors' duties, her Honour was then able to extend liability to all the other Binetter concerns that had knowingly participated in these breaches by virtue of the involvement of their directors. This should ensure that liability follows the money.

The 204 page judgment also deals with numerous other issues, in particular causation and loss, limitations periods and the significance of the failure to give evidence. Although some members of the Binetter family were exonerated on almost all matters, the court found in favour of the liquidators and, hence, ATO. Media reports put the exposure of the Binetter concerns to the ATO at $130m and claim that this is only the beginning.

Significance of the case

Recent Commissioners of Taxation have stressed that corporate tax considerations are of such significance that they should be considered at board level and not merely left to the discretion of corporate functionaries. This case certainly confirms that a company's failure to comply with the tax laws can amount to a breach of directors' duties. This continues the trend towards directors facing greater liabilities for unpaid company tax, such as the 2012 amendments to Div 269 of Sch 1 to the *Taxation Administration Act 1953* (TAA 1953), the directors' penalty regime. It should also always be recalled that under the s 8Y of the TAA 1953, directors may be prosecuted for corporate tax offences, although the Commissioner's default practice is to prosecute the company.

However, this is an extreme case. It was not one dealing with whether directors could be in breach of their duty of care where a company suffers a tax penalty. Rather the directors had engaged their company in transactions that could return no benefit to the company (viewed as a separate legal entity) but rather exposed it to financial risks for the benefit of others.

It is also an extreme case given the evidence of the behaviour of the directors. The behaviour of the parties in generating sham documentation and Michael, in particular, procuring the destruction of documentation held by the bank demanded explanation. The failure to appear to address these matters clearly coloured her Honour's attitude to the taxpayers' case. Other litigation is already pending or ongoing: to vacate the decision in Rawson Finance on the basis of fraud, to access further evidence from Israeli bankers and to even proceed against these banks for their part in facilitating the tax fraud. It is clear from the volume of litigation that this is a running sore within the ATO. The breach of trust and confidence that has unfortunately sometimes been a feature of consultation and engagement between the ATO and practitioners (think CFC rules, consolidation, Nick Petroulias) has reared its head here in spectacular fashion. Michael Binetter was a member of the 2006 ATO's Promoter Penalty Co-design Subcommittee of the National Tax Liaison Group (NTLG).