



## Interest deductibility and hybrid trusts? Not so simple!

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The attractiveness of trusts as a vehicle to undertake income producing activities has been questioned in recent times following statements from the Tax Office concerning streaming income and the use of corporate beneficiaries. The Commissioner has also sought to limit ideal structuring in Taxation Determination TD 2009/17 concerning interest deductibility issues involving certain trusts.

### TD 2009/17 - an outline

This particular TD considers situations where a unitholder in a hybrid trust has used borrowed funds to acquire units (usually to enable the trust to acquire an

income producing asset). The unitholder then seeks to claim an income tax deduction on the borrowed funds.

TD 2009/17 outlined the Commissioner's view on the following question: "Is interest on a loan fully deductible under s 8-1 of the ITAA 1997 when the borrowed moneys are settled by the borrower on trust to benefit the borrower and others?"

In the TD, the Commissioner answered this question in the negative and justified his position as follows:

"1. Interest on a loan used to settle moneys on trust to benefit the borrower and others cannot be deducted in full under section 8-1...

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# Are insurance bonds safe from bankruptcy courts?



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Going into bankruptcy is mostly a last-resort step. It should not be done lightly and the consequences should be clearly understood. While bankruptcy might clear the person's debts (and creditors, including the Tax Office), a dark stain is recorded against the person. Acts such as borrowing funds might, in the short term at least, be virtually impossible.

Generally, the *Bankruptcy Act 1966* enables bankruptcy trustees to recover items like superannuation contributions made prior to bankruptcy, where the contributions were made with the intention to defeat creditors. As a result, certain superannuation contributions made on or after 28 July 2006 may be void against a trustee in bankruptcy and form part of the property available for distribution among the bankrupt's creditors.

This recovery power of bankruptcy trustees could also apply to the acquisition of, for example, insurance bonds where they were acquired with the intention of defeating creditors.

A person contemplating bankruptcy often, nervously, hears the feet of approaching creditors. What, then, if that person has an insurance bond? Could the Bankruptcy Courts seize the insurance bond as well as other assets?

Let's look at the issues.

Section 116(1) of the *Bankruptcy Act 1966* defines "owning" property widely. People "own" property for the purposes of bankruptcy when it:

- belongs to them;
- is vested in them;
- is gifted to them; or
- is controlled by them.

If people:

- "own" the property at the start of the bankruptcy; or
- acquire it after the bankruptcy started (but before they are discharged as a bankrupt);

then it is divisible amongst their creditors at bankruptcy. Even death is no escape. The Trustee in Bankruptcy picks over the remains of the deceased bankrupt.

However, there is a silver lining – the Bankruptcy Act gives limited exemptions. Unless insurance bonds are acquired to defeat creditors, then the Bankruptcy Act expressly exempts insurance bonds as "property". This is regardless of whether you hold the bonds in your self-managed superannuation fund (SMSF) or in your own name.

The determination of whether a person acquired an insurance bond with the intention of defeating creditors falls for consideration on the facts of each case. Generally, if a person transfers property and the "main purpose" for making the transfer is to prevent, hinder or delay property becoming divisible among creditors, then the transfer is void against the Trustee in Bankruptcy. The "main purpose" of a transfer is to defeat creditors where at the time of transfer, it can be

reasonably inferred that the transferor was insolvent (or was about to become insolvent).

## How does the Bankruptcy Act exempt insurance policies?

### Insurance bond in superannuation

Section 116(2) of the Bankruptcy Act excludes as "property":

1. Your interest in:
  - (a) regulated superannuation funds (so any retail, industry or SMSF covered by the SIS Act);
  - (b) approved deposit funds; or
  - (c) an exempt public sector superannuation scheme.

This includes payment from any of these funds, even if the payment is not a pension within the meaning of the SIS Act.

2. Money held in a Retirement Savings Account (RSA).
3. Payments to you from an RSA received on or after the date of the bankruptcy, even if the payment is not a pension or annuity within the meaning of the *Retirement Savings Accounts Act 1997*.

### Insurance bond NOT in superannuation

Section 116(2) of the Bankruptcy Act also exempts from s 116(1) the following property:

1. Assorted property, being:
  - (a) property held in trust for someone else's benefit;
  - (b) personal property with sentimental value;
  - (c) property used to earn income; and
  - (d) property used for personal transport.

As always, there are strict restrictions and value limits on all of these property classes.

2. Policies of life assurance and endowment assurance – but only for the bankrupt's life or the life of their spouse and de-facto. It does not matter whether the bankrupt receives the proceeds on or after the date of bankruptcy. But, beware: if you receive the proceeds before the date you declare bankruptcy, then your creditors snap it up. If you're expecting to receive proceeds, better to declare bankruptcy earlier rather than later – that way the proceeds are "exempt".

## What about the insurance bond?

An insurance bond is clearly a life policy under s 116(2) of the Bankruptcy Act. It is protected against division amongst creditors. This is provided you don't:

- transfer money into the account to defeat creditors;
- transfer the money outside the prescribed examinable period.

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