SUPREME COURT OF QUEENSLAND

CITATION:	*Pullenvale Estates Pty Ltd as Trustee for Mantle Family Trust & Ors v Malone & Anor* [2015] QSC 24
PARTIES:	**PULLENVALE ESTATES PTY LTD as trustee for MANTLE FAMILY TRUST** (first plaintiff) **JIMMY'S ON THE MALL PTY LTD** ABN 74 010 361 574 (second plaintiff) **J L HOLDINGS PTY LIMITED** ACN 010 390 888 (third plaintiff) **HOSPITALITY TRAINING & SERVICES PTY LTD** ABN 76 097 242 227 (fourth plaintiff) **HOT WOK FOOD MAKERS PTY LTD** ABN 15 058 494 447 (fifth plaintiff) **KOBE BRISBANE TRADE AND INVESTMENT CORPORATION PTY LTD** ABN 73 010 390 735 (sixth plaintiff) **NORTHBROOK CORPORATION PTY LTD as trustee for WEYBA TRUST** (seventh plaintiff) **TERRANORA GROUP MANAGEMENT PTY LTD as trustee for TERRANORA GROUP MANAGEMENT TRUST** (eighth plaintiff) **SAINTS HOTELS & RESORTS PTY LTD as trustee for MANTLE PROPERTY TRUST** (ninth plaintiff) **GODFREY NORMAN MANTLE & JENNIFER DEBORAH MANTLE** (tenth plaintiffs) **v** **BILL MALONE** (first defendant) **MALONE'S BUSINESS ADVISORS PTY LTD** ABN 37 792 258 135 (second defendant)
FILE NO/S:	BS 5602 of 2012
DIVISION:	Trial Division
PROCEEDING:	Hearing

ORIGINATING COURT:	Supreme Court at Brisbane
DELIVERED ON:	13 February 2015
DELIVERED AT:	Brisbane
HEARING DATE:	22 September 2014
JUDGE:	Philip McMurdo J
ORDER:	**1. Paragraphs 47(a)-(d), 47(f)-(h), 47(l), 48, 48A, 48AA, 48B, 48C, 49, 50, 50A, 50B and 51 and paragraph A under the heading "Relief Sought" in the statement of claim be struck out.** **2. The plaintiffs are directed to file and serve any amended statement of claim, consistently with these reasons for judgment, within 28 days.** 3. **The application filed on behalf of the first and second defendants on 1 September 2014 is otherwise dismissed.**
CATCHWORDS:	PROCEDURE — SUPREME COURT PROCEDURE — QUEENSLAND — PROCEDURE UNDER UNIFORM CIVIL PROCEDURE RULES AND PREDECESSORS — PLEADING — STATEMENT OF CLAIM — application to strike out sections of further amended statement of claim — where the defendant claims that the amended statement of claim is not pleaded adequately — where parts of the statement of claim were struck out and the plaintiffs given leave to re-plead those claims PROCEDURE — SUPREME COURT PROCEDURE — QUEENSLAND — PROCEDURE UNDER UNIFORM CIVIL PROCEDURE RULES AND PREDECESSORS — where the defendant claims that the amended statement of claim is not pleaded adequately — where the defendant claims that the statement of claim does not plead the damages component of the case in compliance with rule 155 of the *Uniform Civil Procedure Rules* 1999 (Qld) — where the defendant claims that the pleading does not state the exact circumstances in which losses were suffered, the basis upon which amounts claimed have been worked out and matters which would take the defendants by surprise — where parts of the statement of claim were struck out and the plaintiffs given leave to re-plead those claims *Income Tax Assessment Act* 1936 (Cth) *Income Tax Assessment Act* 1997 (Cth) *Uniform Civil Procedure Rules* 1999 (Qld), r 155, r171(1)(b), r 171(2)
COUNSEL:	D B Fraser QC, with P W Telford for the plaintiffs/respondents

D A Savage QC for the defendants/applicants

SOLICITORS: M&K Lawyers for the plaintiff/respondents
HWL Ebsworth for the defendants/applicants

[1] The plaintiffs are a group of companies effectively controlled by the tenth plaintiffs, Mr and Mrs Mantle. The defendants were the plaintiffs' accountants and tax agents. The plaintiffs' case is that in several ways, the defendants failed to provide their services with the care and skill which was required by their contract or contracts with the plaintiffs and by the duties of care which the defendants owed to them.

[2] The plaintiffs' claims relate to the financial years ending 30 June 2006, 30 June 2007 and 30 June 2008. The plaintiffs claim damages which total $2,516,301.99.

[3] The defendants' present complaint is that the [fourth] statement of claim does not plead the damages component of the case as UCPR r 155 requires. They say that the pleading does not state:

(i) the exact circumstances in which the losses were suffered: r 155(2)(b);

(ii) the basis upon which the amounts claimed have been worked out: r 155(2)(c);

(iii) matters which would take the defendants by surprise: r 155(4).

The defendants say that therefore a number of paragraphs of the statement of claim (where the damages case is pleaded) should be struck out as tending to prejudice or delay the fair trial of the proceeding: r 171(1)(b).

[4] In broad terms, the damages which are claimed are referrable to five categories of loss which are described in paragraph 49 of the statement of claim. It is argued that at least four of them are defectively pleaded.

Avoidable tax

[5] The first and largest component is described as "avoidable tax" involving alleged losses totalling $1,188,230. The pleaded facts from which those losses were suffered involve a number of transactions for which the second plaintiff ("JOTM") wrongly claimed deductions in the 2006 - 2008 years.

[6] JOTM made payments (apparently by journal entries) for so-called "purchase rebates" in each of those years to the first and sixth plaintiffs. There were corresponding accounting entries representing that identical amounts were paid by the first and sixth plaintiffs to JOTM, as repayments of moneys which had been lent to them by JOTM. The plaintiffs' case is that these purchase rebates had no commercial or contractual basis and they were simply the creations of the defendants which were recorded in the relevant accounts and income tax returns without consultation with Mr and Mrs Mantle. The Australian Tax Office thought that there was no sufficient basis for them and issued reassessments.

[7] Another alleged error by the defendants was to record a so-called "marketing support" payment in the 2008 year, being a payment by JOTM to the first and sixth plaintiffs. Corresponding amounts were recorded as paid by those companies to JOTM as repayments of JOTM's loans to them. Again the plaintiffs' case is that there was no

commercial or contractual basis for this payment and the defendants should not have recorded it within the accounts and included the accounts in that respect in the 2008 tax returns for the relevant entities. The payments resulted in reassessments by the ATO.

[8] The third category of errors which relate to the so-called "avoidable tax" involves interest expenses, which were treated as incurred by, and deductions available to, JOTM for each of the three subject years. In truth, the plaintiffs allege, these were expenses referrable to borrowings made by the seventh and eighth plaintiffs. Again there were reassessments by the ATO to take account of these errors.

[9] The reassessments in consequence of these errors had several effects. The taxable incomes of the first, sixth, seventh and eighth plaintiffs were decreased. The taxable incomes of the first and sixth plaintiffs were decreased by the removal of the purported purchase rebates and marketing support payments as income. The taxable incomes of the seventh and eighth plaintiffs were reduced by the relevant interest payments becoming included as deductions in their favour rather than in favour of JOTM. But a further effect was the inclusion, in the amended assessments for the first, seventh and eighth plaintiffs of amounts as deemed dividends under Division 7A of the *Income Tax Assessment Act* 1936 (Cth). The total amounts of these deemed dividends was $3,960,765.[1] At a tax rate of 30 per cent, this represented a total tax payable of $1,188,230.[2] Amounts of this total were not actually paid as tax, because $1,105,496 of this total of $1,188,230 was effectively satisfied by the use of carried forward tax losses.[3] Nevertheless, the total claimed as "avoidable tax" is that total of $1,188,230.

[10] The plaintiffs say that these losses could have been avoided by several alternative courses of action, any of which the defendants should have advised the plaintiffs to pursue. The first of them is what Mr Molesworth, an independent expert who has written a report on the instructions of the defendants' lawyers, described as the "Full Repayment Option". This would have involved treating the various recorded payments for the purchase rebates, the marketing support and interest, instead as loans by JOTM to the first, seventh and eighth plaintiffs and having those loans repaid by fully franked dividends in each year in amounts corresponding to those loans. In that way, there would have been no deemed dividends under Division 7A.

[11] Each of the first, seventh and eighth plaintiffs was a trustee of a discretionary trust. Where a beneficiary who is not under a legal disability is presently entitled to a share of the income of a trust estate, that share is assessable income of the beneficiary.[4] As already noted, the incidence of the deemed dividends was for the most part through the loss of carried forward losses, which has resulted in the claims in that respect being made by the first, seventh and eighth plaintiffs, rather than by any beneficiaries under the trust. The burden of the tax actually paid on the deemed dividends, according to annexure 6 of the statement of claim, has fallen upon Mr and Mrs Mantle and the fifth plaintiff.

[12] According to Mr Molesworth, whose opinion was the basis for the defendants' submissions on this application, more information would be required in order to make a comparison between the taxation positions of the plaintiffs in the events which did

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1 Statement of claim par [35].
2 Statement of claim par [36].
3 Annexure 6 to the amended statement of claim.
4 *Income Tax Assessment Act* 1936 (Cth) s 97.

happen and what should have been their positions. Under this "Full Repayment" case, the first, seventh and eighth plaintiffs would have received assessable income which, it is to be expected, would have been distributed by them under the trusts. And Mr Molesworth says that it cannot be assumed that those defendants would have distributed this hypothetical income (which would have been by way of fully franked dividends from JOTM) in the same way as they distributed the actual income of those trusts in the subject years. He says that there is insufficient information available from the pleaded facts in order to make the necessary comparison.

[13] That criticism of the pleading is persuasive. The Full Repayment Option does require the comparison described by Mr Molesworth. Facts are not pleaded which could found an assessment of the several positions of the plaintiffs under the full repayment hypothesis.

[14] Mr Molesworth says that he is unable to form an opinion about the likely losses according to the Full Repayment case without considering the tax returns for each of the plaintiffs for each of the three subject years, their financial statements for those years, the constitution of each of the corporate plaintiffs and the trust deeds for each of the relevant trusts. It is to be expected that such information would be provided by disclosure in this proceeding. But although that information might enable Mr Molesworth to provide an opinion, still the present difficulty would remain, namely the absence of a properly pleaded case. Mr Molesworth may become able to form his opinion as to the likely loss or losses. But the defendants nevertheless are entitled to know what is the case which the plaintiffs advance by a pleading which sets out the material facts and circumstances of that case. In my view, the "Full Repayment" case should be struck out.

[15] An alternative case, pleaded in paragraph 47(d) and 48C, is described by Mr Molesworth as the "Loan Agreement Option". The case here is that the defendants should have advised that the advances and payments by JOTM be treated as loans to the recipients, and that they be recorded by loan agreements which complied with s 109N of the *Income Tax Assessment Act* 1936 (Cth) so as to prevent those loans being treated as deemed dividends under Division 7A. Section 109N requires such a loan agreement to provide for the payment of interest, at a rate which equals or exceeds a "Benchmark interest rate" (as defined by s 109N(2)). Further, the maximum permitted term for such a loan is usually seven years: s 109N(3).

[16] Paragraph 48C pleads that the making of loan agreements complying with s 109N would have avoided the application of Division 7A. But the statement of claim does not plead what would have been the terms of such agreements, and in particular, the agreed duration of the loans and the agreed rates of interest. Nor does it reveal how those payments would have been made over the life of the loans. Mr Molesworth identifies several possibilities: the payment of dividends to the borrowers or the earning of income by the borrowers from JOTM (in each case to be offset against the required interest and loan repayments) or funding from an external source.

[17] If the plaintiffs' case is to be that repayments under such loans would have been made from dividends paid by JOTM, then there is essentially the same difficulty in identifying the plaintiffs' case as I have discussed in relation to the "Full Repayment" case. If the plaintiffs' case is to be that interest and repayments would have been funded from income derived by the first, seventh and eighth plaintiffs, then the plaintiffs

should identify the impact upon the several positions of the plaintiffs from the derivation of that income, which would vary according to the way in which the trustees exercised their discretions to distribute the income. And if the interest and repayments were to be funded from an external source, the plaintiffs should plead the facts relating to that source and, in particular, the likely terms and cost of that external funding. Therefore, the case based upon this alternative "Loan Agreement" hypothesis is incompletely pleaded.

[18] The further case pleaded in relation to the deemed dividends is that described by Mr Molesworth as the "Guarantee Fee Option" and is pleaded in paragraphs 47(da), 47(f), 47(g), 47(l) and 48B. Under this hypothesis, the advances and payments by JOTM to the seventh and eighth plaintiffs would have been treated as loans to them, to be repaid by offsetting a so-called guarantee fee to be earned by them from JOTM. But this fee would have constituted assessable income in the hands of the seventh and eighth plaintiffs, again subject to the distribution of that income under their trusts. Therefore, there is again the omission of a pleaded case of how this income would have been distributed. Without knowing that element of the hypothesis, it would be impossible to compare the positions of the several plaintiffs, as they would have been, with the positions which were reached on the events which did occur.

[19] In summary the pleaded case to recover (in total) $1,188,230 as "avoidable tax" is incomplete. The case is that the losses were suffered, not only because certain things were done by the defendants, but also because certain other things should have been done by them. It is for the plaintiffs to plead and prove certain losses from the defendants' conduct, constituted by alleged acts and omissions.

[20] The unpleaded facts here are not matters for the defendants to plead. They are facts which, if unpleaded and thereby unproved by the plaintiffs, would result in the plaintiffs failing to establish a loss or losses from the alleged acts and omissions. For example, there is the "Guarantee Fee" case. If the court was persuaded that such a course of action would have been followed, it would infer that there would have been a corresponding tax burden on some of the plaintiffs. It would be necessary for the court to make findings as to the particular incidence of that burden amongst the plaintiffs, in order to make the necessary comparison between a plaintiff's hypothetical position and its actual position. It would not be for the defendants to prove how that tax burden would have been distributed. The plaintiffs must plead the facts which, if they are proved, would found a conclusion that the plaintiffs have suffered several losses in amounts for which they should be compensated.

Loss of franking credits

[21] Paragraph 37 alleges that a consequence of the application of Division 7A was that the franking account balance of JOTM was reduced by $698,861, corresponding to the amount of the franking credits attributable to the Deemed Dividends for the 2006 financial year. Therefore, it is alleged, these franking or imputation credits were unable to be used by "the Plaintiffs".

[22] Paragraph 48 alleges that the lost franking credits could have been "effectively deployed to recover their full value by adopting the steps pleaded in paragraphs 48A and 48AA hereof". Those paragraphs plead that properly advised, JOTM would have declared dividends in the 2006-2008 years equal to the amount of the Deemed

Dividends in each year to "transfer the benefit of the franking credits to its shareholders …". The shareholders of JOTM were the seventh, eighth and ninth plaintiffs. The fully franked dividends would then have been used by the seventh and eighth plaintiffs to repay the so-called advances to them by JOTM.[5] The ninth plaintiff (also a trustee) would have distributed the dividends paid to it and the amount of franking credits it received, to the first plaintiff which would then have applied those distributions in repayment of the advances by JOTM to it. The outcome, it is alleged in paragraph 48AA, would have been that the first, seventh and eighth plaintiffs "and through them, the beneficiaries of the trusts of which [they] were trustees, would [have received] the benefit of the franking credits [which] …would not have been lost".

[23] It therefore appears that the plaintiffs' case is premised upon the hypothesis of certain distributions being made to the beneficiaries of the trusts administered by the first, seventh and eighth plaintiffs. But absent a pleading as to what those distributions would have been, the particular loss of a plaintiff could not be assessed.

[24] The statement of claim does not allege what those distributions would have been. Rather, the lost franking credits are claimed by the first, seventh and eighth plaintiffs (as appears from annexure 6 of the statement of claim). That is inconsistent with the facts pleaded, in particular, in paragraph 48AA. In my conclusion, the pleading is incomplete on this component of the damages case.

Penalties and interest

[25] Another component of the alleged losses is the amounts of penalties and interest paid to the ATO following the reassessments. These are pleaded in paragraphs 31 to 33 to total $568,830. The particular burdens, from those payments, which fell upon certain of the plaintiffs are identified by annexures 3 and 6.

[26] But Mr Molesworth says that an allowance has not been made within the statement of claim for the deductibility of the interest payments under s 25-5(1)(c) of the *Income Tax Assessment Act* 1997 (Cth). The plaintiffs submit that this is simply an offset amount which is something to be pleaded by the defendants.

[27] The defendants do not have the same difficulty with this component as they have in respect of the "avoidable tax" component. For this component, the defendants *are* informed of the facts which constitute the relevant hypothesis, because they are informed of what would have been done with the provision of due care and skill by the defendants. It is from that information that the defendants are able to point to an amount which should be brought into account in the calculation of the relevant losses. It would be preferable for whatever is the plaintiffs' case, on the question of the deductibility of these interest payments, to appear in their statement of claim. But I am not persuaded that its omission offends the pleading rules and warrants this component of the claim being struck out.

[28] An alternative case is pleaded for orders pursuant to s 251M of the *Income Tax Assessment Act* 1936 in respect of the interest and penalties paid to the ATO. In this part of the pleading, the plaintiffs do make an allowance for the deductibility of the interest paid to the ATO: paragraph 55 and annexure 5. The same allowances not made in the general law claims by the plaintiffs for the interest paid to the ATO.

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[5] Under the "Full Repayment" hypothesis.

Legal and accounting fees and expenses

[29] Paragraph 45 pleads that "the Plaintiffs" have incurred certain fees and expenses in addressing the issues raised by the ATO leading to the reassessments. The total paid was $44,860, which is apportioned between the plaintiffs (and some other Mantle companies) in annexure 6.

[30] The arguments here are the same as those for the interest paid to the ATO. These fees, according to Mr Molesworth, would be deductible under s 25-5(1)(a) of the *Income Tax Assessment Act* 1997. My conclusion on this argument is the same.

Alternative claim by Mr and Mrs Mantle

[31] Paragraph 50A pleads a certain division of the total alleged damages of $2,516,301.99 amongst several parties. Curiously, it shows some amounts as referrable to four companies which are not plaintiffs but which are pleaded to have been at all times "beneficiaries or potential beneficiaries of the Mantle Family Trust". The amounts allocated to them total $10,695. The basis for that allocation is not apparent. The balance of the total of $2,516,301.99 is divided amongst the plaintiffs, with an amount of $52,349 being claimed by Mr Mantle and $52,691 being claimed by Mrs Mantle.

[32] Paragraph 51 is then as follows:

> "Alternatively, the Mantles have suffered loss and damage in the amount of $2,516,301.99 occasioned by the avoidable tax, loss of franking credits, family trust distribution tax excess, penalties, and interest paid by them and legal and accounting fees and expenses incurred as aforesaid by virtue of the consequent diminution in the value to them of their interests in, and entitlements to control, the Mantle Group entities."

[33] However, it is impossible to discern how the matters otherwise alleged in the statement of claim have led to a diminution in the value of any interest held by Mr and Mrs Mantle, whatever is meant by "their interests in … the Mantle Group entities". Further, their "entitlements to control" are not revealed by the statement of claim and nor does the pleading explain how those entitlements to control the entities can be translated to entitlements for damages for the alleged losses. Therefore, this claim on behalf of Mr and Mrs Mantle should be struck out.

Orders

[34] The defendants applied for an order "that the claim for damages in the plaintiffs' [statement of claim] be struck out" and further or alternatively for a further amended statement of claim to be filed within a certain time.

[35] The applicants' brief outline of argument identified certain paragraphs, namely 44, 48, 49, 50, 50A, 50B, 51, 54 and annexures 3, 4 and 6, as the subject of the strike-out application. However, neither the outline nor the oral submissions explained why those paragraphs and not others, including some mentioned within this judgment, were particularly challenged. As I have noted, the defendants' argument was based upon Mr Molesworth's criticisms, most of which I have accepted.

[36] This is not a case where all of the damages case is deficiently pleaded. I have mentioned that there are five categories of loss only four of which seem to be

challenged in the present application. The fifth component is that which is described as "family trust distribution excess" which is pleaded in paragraphs 38 and 38A and for which $15,521 is claimed. I have also rejected the argument to strike out the components for interest paid to the ATO and legal and accounting fees.

[37] Some paragraphs plead matters which relate to both the deficiently pleaded components and other components. The same may be said of the annexures. The outcome of this application should be to strike out those parts of the pleading in which the claims for "avoidable tax" and lost franking credits are made, with the plaintiffs being able to re-plead those claims in a way which is consistent with these reasons for judgment. With that outcome in mind, it is appropriate to strike out paragraphs 47(a)-(d), 47(f)-(h), 47(l), 48, 48A, 48AA, 48B, 48C, 49, 50, 50A, 50B and 51 together with the paragraph A under the heading "Relief Sought" in the statement of claim should be struck out. The plaintiffs will be directed to file and serve any amended statement of claim, consistently with these reasons for judgment, within 28 days. The application filed on 1 September 2014 is otherwise dismissed.