



Mochkin appeal

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Levi Mochkin is the most appealing person of importance to the financial services industry for 2003

Levi Mochkin is a man with a real sense of appeal. All in the financial services industry owe him a debt of gratitude. In this Financial Services Reform (FSR)-induced world, you should get to know him. He is a man of deep convictions. He is an ordained rabbi, and he and his wife are trustees of the L&M Charitable Trust through which has flowed millions of dollars for the benefit of many.

BRW once recognised him as among our wealthiest 200 individuals, but the following year he was dropped. It is little wonder when you consider he has seven children and has given away millions.

Why do I find him so appealing? Why should you appeal with gratitude to Levi Mochkin? The truth is that it was the tax office and the Full Federal Court that found Levi Mochkin so personally appealing. The tax office started the appeal; it asked him for more personal tax, and claimed that all of the brokerage income was personal to him as a proper authority holder in a stockbroking servicing business. He appealed and the tax office said no, so he appealed again and this time the Federal Court said yes and no. So the tax office and Mochkin appealed, both to the Full Federal Court.

It is the February 21, 2003 unanimous Full Federal Court judgment that you should find most appealing. Why? Because the judgment challenges many of the tax office views of the extent of their powers under the alienation of personal services income tax rules. The essential starting point for these rules is found in section 84-5, which says your ordinary income or statutory income, or the ordinary or statutory income of any other entity, is your personal services income if the income is mainly a reward for your personal efforts or skills (or would mainly be such a reward if it was your income). The tax office's main complaint with Mochkin was that the income of two trusts associated with him was really his.

In 1987, Mochkin, who had not previously worked in the stockbroking industry, personally entered into a commission-sharing arrangement with a firm of stockbrokers, Bridges Son & Shepherd. This was terminated soon after due to a dispute about his personal liability for the default of his clients in completing share transactions.

Later Mochkin entered into a similar arrangement with a different firm of stockbrokers, Pembroke Securities. In February 1988, he caused Daccar, the trustee of the number one family trust, to enter into a commission-sharing agreement with Pembroke in place of his previous agreement. Importantly, the earlier court found as fact that a motivation for altering the arrangement with Pembroke from himself to Daccar was the fear of personal litigation. This was made more real by the fact that Bridges had pressed its claim against him arising from the default of his clients when he was personally signed to that stockbroker. At the time of putting Daccar into the position, litigation between Bridges and Mochkin was nearing finality.

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In June 1989 Ledger Holdings as trustee of the Mochkin family (number two) trust was created, and entered into a commission-sharing agreement with Pembroke. In 1990 this was terminated and replaced and later replaced again with an agreement with Bell Securities.

The years in stockbroking were good to Mochkin and the trustee companies but it was the tax office's contention that all of it should have been attributed to him personally. Over the years, this ranged from a low of \$171,504 in 1993 through to \$2,614,731 in 1997.

The tax office first complained that the commission arising from the Great Central Mines share placement did not belong to Daccar but to Mochkin. On this ground he lost, and it would appear from his appeal to the Full Federal Court judgment that he wasn't very confident in this argument, as this was not fought hard.

The second ground of attack is the one of more interest to the financial services industry. The tax office claimed that he earned all the commission income as a proper authority holder of the securities dealer. As a consequence, his alienation of the income to Ledger failed and he was personally assessable to tax on the income.

If that argument did not work the tax office also claimed that section 19 of the 1936 Tax Act should apply to cause the "Ledger income" that was re-directed by him to be deemed to be his income. Finally, the tax office argued that it enjoyed Part IVA anti-avoidance powers and was able to "re-write" the income arrangements and cause Mochkin to be personally taxable on it.

The tax office lost these arguments on all accounts.

Why did Mochkin lose the Daccar argument? Look at the facts. In mid-1991, Mochkin, while in New York, was given the opportunity to place a parcel of shares with a value of \$9.5 million in Great Central Mines. When it became apparent to him that the placement could be made to clients of Ledger, he requested permission from his dealer to make the placement through it, but this was declined.

Accordingly, those of Ledger's clients who had agreed to take up the shares made arrangements directly with Great Central. Mochkin requested Joe Gutnick, the principal of Great Central Mines, to pay a finder's fee because (as the primary judge found) "his own efforts in securing the placement had imposed a moral, if not a legal, obligation on Great Central to pay it [the fee] to him". In May 1992, a \$564,270 fee was paid, at Mochkin's direction, to Daccar.

The bottom line? The primary judge found that, even if the payment of the finder's fee was properly to be characterised as gratuitous, it was made to Mochkin or at his direction in the course of or as a result of his vocation as a stockbroker or investment adviser. Accordingly, it was his income. In effect, the court said if it is your personal effort, it is your income. There is nothing surprising in this. It is basic tax law. But this is also what the tax office argued in the "Ledger scheme" and it lost! What was the difference?

It is important to know what the Ledger business was made up of. Ledger gave Mochkin's dealer the guarantee for client debts that he had refused to give. Ledger maintained an extensive array of information technology, much of it purchased from Bell. Ledger also expended money on a computer and undertook an extensive advertising campaign to promote its services. The primary judge also

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found that at all relevant times, Mochkin was the head of what could be regarded as the "Ledger team", a small group of persons who were employed by or contracted to Ledger.

In the final analysis it did not matter that various brokers provided Ledger with facilities to enable it to service clients, including floor space, research facilities, telephone and courier services and a kosher kitchen. Bell, too, provided similar facilities to Ledger, but was paid a monthly fee for the facilities and services it provided.

In effect the court found that Mochkin's trust company, Ledger, had a business structure providing genuine commercial services in return for commission income. The services included indemnifying brokers against client defaults, something Mochkin was unwilling to provide on his own account. The business conducted by Daccar and Ledger proved to be substantially more than a one person operation.

It was clear to the court that Mochkin had tax advantages in mind in choosing a discretionary tax structure as the means of carrying out the scheme. Doubtless, there were other ways in which he could have chosen to immunise himself from personal liability. But the question posed by the anti-tax avoidance rules is not whether the taxpayer could have chosen a less tax-effective means of achieving his commercial objective of immunising himself from personal liability. The question is whether, in view of the matters identified in s177D, it is reasonable to conclude that the taxpayer's purpose in entering into or carrying out the scheme was to obtain a tax benefit.

So as far as the Ledger scheme was concerned, Mochkin won all of his (Ledger) arguments. This income was not his because Ledger derived it in a real commercial and legal sense. The existence of staff and contractors helped this argument as well as the onus of liability for client defaults; Ledger was liable. Put in the modern alienation of personal services income perspective, the court agreed that the Ledger income, while it may have involved Mochkin's personal exertion, was not the result of his personal services exertion.

Putting this in the context of the modern tax law of Section 84 of the 1997 Tax Act, if your business is like Mochkin's, the alienation rules simply do not even start to apply. Mochkin, at least as far as the Ledger income was concerned, would not have been subject to the new alienation of personal services income rules. He would not have had to consider whether he had a personal services business - the rules simply would not have applied.

The remainder of the court's judgment was given over to the tax office anti-avoidance or Part IVA claim. The tax office argument rested on the question: was it all done with the dominant purpose of obtaining the tax benefits? On this point, the Federal Court and subsequent Full Federal Court were clear. There was a clear tax benefit outcome; however, Mochkin's history within the financial services industry made clear that his dominant purpose was to immunise himself personally from liability for client defaults or other debts or obligations of the business. Another purpose was to allow the business to build up goodwill, which could be detached from him.

There may be some merit to tax office disappointment, at least as far as it relates to the Part IVA claim. There is some suggestion that the scheme identified by the commissioner left the court with no other conclusion. Put another way, the tax office lost the part IVA claim because it ran the wrong argument. Hindsight is a wonderful teacher. Had the commissioner identified another scheme, would the result have been different?

Sadly for the industry, for reasons privately held between them, Mochkin has agreed with the Australian Securities & Investments Commission (ASIC) to no longer work as a representative of another. Nevertheless, his tenacity against the tax office and success in defeating a personal services income and part IVA claim give him the title of the most appealing person of importance to the financial services industry for 2003.

Levi Mochkin, thank you.