Shelf Organisations

Accountants and their clients are taking avoidable risks by using shelf organisations to obtain companies, trusts or superannuation funds.

David Garde

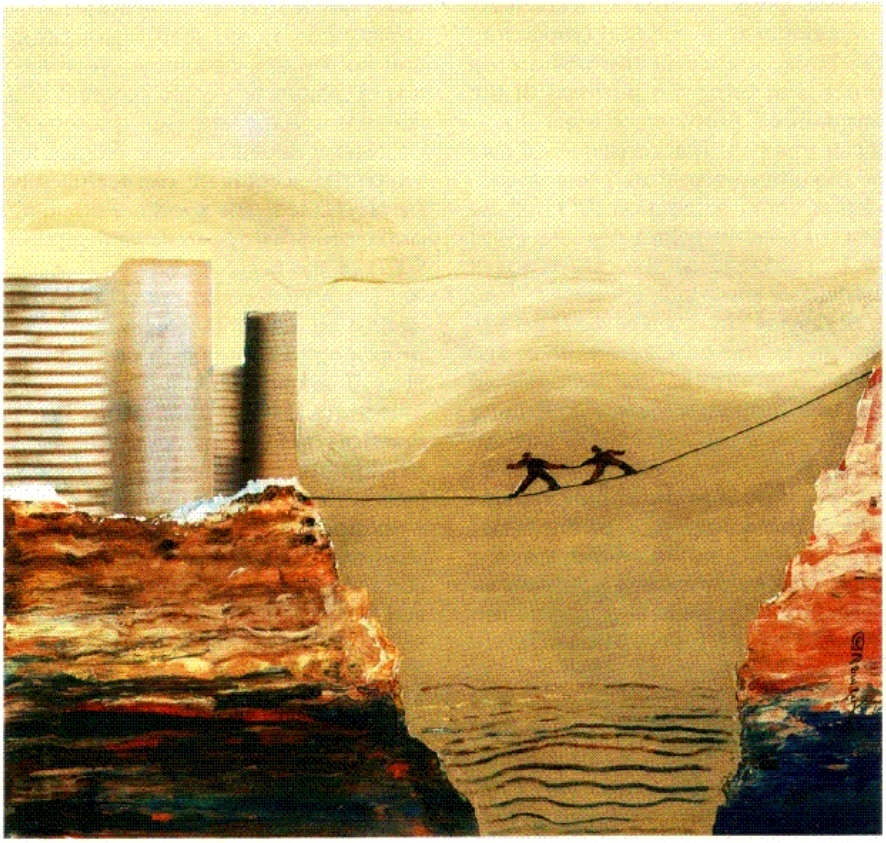


Illustration: Regina Newey

IN AN ARTICLE 'WHEN IS TAXATION Advice Legal Advice?' by Noel Davis,[1] offences applying to unqualified preparers of legal documents for reward under the legal profession legislation of the States were considered. The purpose of this article is to extend that examination to consider the consequences for accountants and their clients of the use by accountants of providers of shelf companies, 'standard' form trusts and superannuation funds who are not qualified in law and so not entitled to practise. These providers are referred to in this article as 'shelf organisations'.

The types of consequences to be considered are:

- criminal and statutory consequences;
- ethical consequences; and
- professional indemnity insurance consequences.

The authority on which the propositions of law in this article are based are to be found in the Victorian law which is broadly similar to the law operating in the other States and Territories of Australia. This is similar to the use of authority from a Victorian standpoint by the Australian Society of CPAs in the ASCPA's Ethical Standard PP3 'Preparation of Legal Documents'.

CRIMINAL AND STATUTORY CONSEQUENCES

As the article by Mr Davis remains a pertinent analysis of the relevant offences under the legal profession legislation, it is not proposed to review those offences in this article to the same extent. However, as the court cases considered by Mr Davis mirror the activities of shelf organisations it is useful to recap the facts and convictions in those cases:

Barrister's Board of WA v Palm Management Pty Ltd.[2] The accused were unqualified persons who performed work in connection with the transfer of a hardware business conducted in a partnership to a family trust with a corporate trustee. They were also involved in the setting up of a superannuation scheme in connection with the business. In the course of this work they prepared a memorandum and articles of association, a deed of settlement of the family trust and a superannuation trust deed.

The accused were convicted under offences contained in the Legal Practitioners Act (WA) 1893 in each instance.

Barristers Board of WA v Central Tax Services.[3] Central Tax Services was charged with performing legal work by providing a memorandum and articles of association of a shelf company and discretionary trust deed produced from a precedent held by Central Tax Services and advice recommending the carrying on of activities in a discretionary trust.

It was found that the provision of tax advice in conjunction with the preparation of documents constituted offences under the Legal Practitioners Act (WA) 1893. Franklyn J found that the mere inclusion in a precedent trust deed of client information is sufficient to constitute the illegal preparation of a trust deed. Thus it was found by Franklyn J that the mere inclusion of beneficiaries, trustees, appointors, guardians or the vesting date can constitute an offence under the Act where done for reward by someone other than a legal practitioner.

It is not widely known that the Secretary of the Law Institute of Victoria regularly refers instances of unqualified legal practice to the police for prosecution.

In Victoria, it is also possible for the Secretary to seek a restraining order under subsection 90(7) of the Legal

Profession Practice Act (Vic) 1958 to prevent a person from implying or holding out that he or she is entitled to practise as a legal practitioner.[4]

Although a restraining order does not amount to a criminal conviction, the consequence of the restraining order is to bring the business of the unqualified preparer of legal documents to a halt. That consequence may be more draconian than a fine or conviction under subsection 92(1) of the Legal Profession Practice Act (Vic) 1958 [5] particularly in the case of a well established shelf organisation.

In Cornall, Secretary of the Law Institute of Victoria v Superannuation Systems (Aust) Pty Ltd,[6] the Secretary of the Law Institute sought a restraining order under subsection 90(7) of the Legal Profession Practice Act (Vic) 1958 against Superannuation Systems where that company's promotional material indicated, *inter alia*, that the company could "provide you with all necessary documentation to establish or amend your fund". The Secretary was not successful in obtaining the order sought. It was established that the principals of Superannuation Systems had good credentials for superannuation and life insurance. However, these credentials did not seem to affect the court's decision and it was the lack of other evidence that was found to be critical. The evidence before the Supreme Court did not indicate that legal documents had in fact been prepared for reward – the only relevant evidence was promotional material which indicated that the company was prepared to draw up legal documents.

Tadgell J stated: "It would be altogether different, of course, if there were proof that the company or either of the individual defendants had done anything at all of the kind that the pamphlet held them out as prepared to do." [7]

It is therefore likely that the Law Institute of Victoria will be loath to commence proceedings unless it can produce evidence (e.g. by subpoena from an accountant's file) which demonstrates that a shelf organisation has prepared documentation setting up a company or a trust fund and has been paid for it.

These sanctions can be invoked against shelf organisations and their principals. Thus when an accountant orders, for example, a trust deed for one of the accountant's clients from a shelf organisation then the primary offence (or matter to be restrained) is committed by the shelf organisation and not by the accountant. Nevertheless, a magistrate's court may find that the accountant has aided, abetted, counselled or procured the offence for which the accountant can technically be prosecuted. The specific restraining order provided for under subsection 90(7) of the Legal Profession Practice Act (Vic) 1958 could not be directed against an accountant who is merely proposing to continue to use the services of an unqualified person.

Sections 53 and 55A of the Trade Practices Act (Commonwealth) 1974 would also be of concern to accountants in these circumstances.

Section 53 states: "A corporation shall not, in trade and commerce, in connection with the supply of goods and services or in connection with the promotion by any means of the supply or use of goods or services:

(aa) falsely represent that services are of a particular standard, quality or grade . . .

(c) represent that goods or services have sponsorship, approval, performance characteristics, accessories, use or benefits they do not have . . ."

Section 55A states: "A corporation shall not, in trade and commerce, engage in conduct that is liable to mislead the public as to the nature, the characteristics, the suitability for the purpose or the quality of any services."

The breach of sections 53 or 55A constitutes an offence with five-figure fines prescribed. Those sections are an adjunct of section 52 of the Trade Practices Act (Commonwealth) 1974. Section 52 imposes a civil liability where corporations engage or are likely to engage in misleading or deceptive conduct in trade or commerce.

Representations concerning the products of shelf organisations by accountants operating through incorporated accounting practices can be caught by sections 52, 53 and 55A of the Trade Practices Act (Commonwealth) 1974. As far as accountants who are not operating through incorporated practices are concerned, the Fair Trading Act (Vic) 1985[8] adopts the relevant parts of the Trade Practices Act (Commonwealth) 1974 and applies them concomitantly to individuals such as accountants and unincorporated accounting practices.

Although the Legal Profession Practice Act provisions date from the 19th century, they could be described as consumer protection legislation. Where accountants supply companies or trusts or funds which they know, or should have known, were prepared in breach of the consumer standards in the Act, then representations concerning the suitability or standard of these companies or trusts or funds, or the proffering of such companies or trusts or funds where a client would expect their constituent documents to be prepared by a qualified person, in accordance with the law, when they are not could amount to offences and civil breaches under these sections of the Trade Practices Act and the Fair Trading Act. It would follow that, even if companies or trusts or funds would have been regarded as being of an acceptable "standard, quality or grade", as "suitable" and as having the necessary "sponsorship, approval, and so on" had they been supplied by a legal practitioner, the very fact that they are supplied by an unqualified person is liable to make involvement in the supplying of these services a breach of the provisions.

When an accountant orders a trust deed for a client from a shelf organisation, the primary offence is committed by the shelf organisation, not the accountant.

ETHICAL CONSIDERATIONS

In the Australian Society of CPAs Ethical Standard PP3 'Preparation of Legal Documents' (PP3), the Society states that the preparation of memoranda and articles of association and like documents is an unethical practice if

undertaken by persons other than a client's qualified legal advisers.

PP3 is generally honoured by members of the Society as far as the conduct of their own practices is concerned. However, it does not follow that PP3 was intended to be limited to be a statement of what is unethical as far as the conduct of a member of the Society is concerned. PP3 was not released simply to limit what accountants can do in their practices. It is part of a wider agenda to protect the public from work done by unqualified persons. Professional ethics are framed to reflect what clients expect from professionals and not just what professionals expect of themselves. The spirit of the professional ethic is disregarded if the accountant refrains from doing a prohibited act for a client, and then engages some other unqualified person to do the same prohibited act.

INSURANCE CONSEQUENCES

In addition to the statutory consequences discussed so far, there is also the possibility that an accountant's client may seek redress for companies or trusts or funds negligently provided. What will be the accountant's position in these circumstances?

Where a legal practitioner is engaged to draw up a legal document, it is possible for an accountant or the accountant's client (depending on who is the client of the legal practitioner) to seek redress against the legal practitioner for negligently drawn legal documents where that negligence causes loss to the client. The legal practitioner should be insured by professional indemnity insurance.

It is unlikely that a shelf organisation will be similarly insured. There is no compulsory requirement that a company, which is not an incorporated 'professional', carry professional indemnity insurance. This means that any given shelf organisation will probably not have professional indemnity insurance.

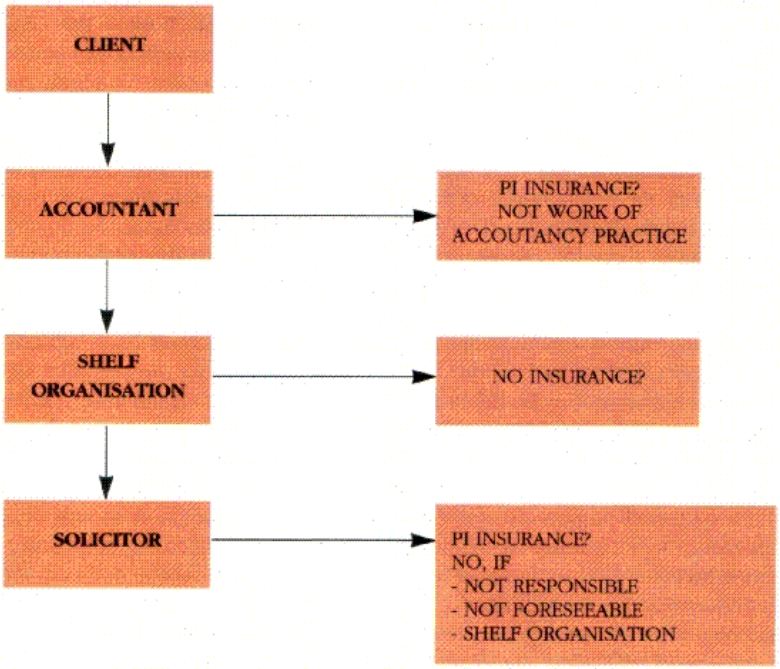
Many shelf organisations seem to run their businesses through companies. Others are run via business names owned by companies. It is possible that these are merely 'two-dollar' companies without sufficient assets to meet any liability claims.

It seems to be normal for shelf organisations to engage legal practitioners to draw up their precedent documents. Some of these organisations are apparently owned or controlled by legal practitioners and, in effect, that owner or controller is limiting his or her professional liability as a legal practitioner by conducting that aspect of legal practice under the guise of a company. Therefore it is feasible that a legal practitioner engaged to draw precedent documents could be 'joined' to proceedings against the shelf organisation and it may be found by the court that the legal practitioner is ultimately responsible for the negligent preparation of the legal documents. However, there are problems in establishing the legal practitioner's responsibility in these circumstances.

- The fault may not have been in the generic document. For example a discretionary trust may have been prepared using an incomplete precedent, but the shelf organisation, which has overseen the implementation of the precedent, has included the wrong beneficiaries. Or the connection or 'foreseeability' between the legal practitioner, the shelf organisation, the accountant and the circumstances of the accountant's client may be too remote for the legal practitioner to be found at fault for the loss suffered by the accountant's client.
- The Victorian Solicitors' Liability Committee (the sole insurer of Victorian solicitors for professional indemnity purposes) has excluded liability in the solicitors' professional indemnity policy for work done by solicitors for conveyancing companies (which is akin to the work done by shelf organisations).[9] The policy does not presently exclude any work done by solicitors providing legal services. However, such an exclusion would be logical.
- The shelf organisation may prefer to protect its legal practitioner even if it means that the shelf organisation will be wound up. Even if a legal practitioner is joined in proceedings, recovery against the legal practitioner and the legal practitioner's insurers is still difficult if the shelf organisation is reluctant to disclose the nature of its instructions to the legal practitioner and

Diagram 1

THE CLIENT'S NEGLIGENCE OR CIVIL LIABILITY CLAIM AGAINST THE SHELF ORGANISATION



what the legal practitioner actually did.

If the legal practitioner is responsible when something goes wrong with a company a trust or a fund, but the legal practitioner's insurers will not indemnify and the legal practitioner is impecunious, or the legal practitioner is not responsible and the shelf organisation is impecunious, the accountant's client could look to the accountant for compensation.

Although the accountant has had nothing to do with the drawing up of documents for setting up a company, trust or fund, the omission to use or recommend a qualified person in accordance with statutory and/or ethical responsibilities would appear to be sufficient grounds for the client to win a negligence action.

Liability under the Trade Practices Act (Commonwealth) 1974 or the Fair Trading Act (Vic) 1985 may not necessarily arise from a mere omission to use a qualified person. However, representations or conduct by an accountant which leads the client to the engagement of an unqualified person will be sufficient to enable the client to commence civil action under the legislation in addition to attracting criminal liability and a liability to the client for negligence.

The accountant may seek to rely on his or her professional indemnity insurance cover if a negligence action under the Trade Practices Act (Commonwealth) 1974 or Fair Trading Act (Vic) 1985 or any other liability arises (see diagram).

Unlike the insurance for solicitors in Victoria, professional indemnity insurance is provided for accountants by a number of insurance brokers so it is not possible to make a definitive generalisation concerning the adequacy of cover. The policy recommended by the Society [10] has been considered as a sample policy for the purposes of this article. Insured activities are broadly stated to be activities carried on as part of an accounting practice. As outlined previously, the drawing up of legal documents may be outside the activities carried on as part of an accounting practice. It may therefore be possible for insurers who insure accountants for liabilities arising from accounting practice or accounting work to challenge claims on the basis that a liability arising from the provision of a defective company, trust or fund did not arise from accounting practice or accounting work.

SHELF COMPANIES – A LESSER PROBLEM?

Some people believe that shelf organisations involved in the conversion of shelf companies for clients face fewer of the legal difficulties discussed in this article than do shelf organisations involved in the incorporation of companies, or the setting up of trusts and superannuation funds.

Moreover, the activities of shelf organisations which merely convert companies in Australia and overseas are widely accepted commercially. That is in contrast to the activities of shelf organisations which prepare legal documents, such as memoranda and articles of association, trust deeds and superannuation fund deeds for clients.

The explanation of why shelf organisations which merely convert shelf companies face fewer legal difficulties is that shelf companies are set up by and for the shelf organisations themselves (with the shelf organisation owners or employees typically becoming the officers and shareholders of the company). Therefore, as there is no restriction on people doing legal work for themselves, the shelf organisation sells the company once the legal work involved in drawing up the memorandum and articles of association is done.

However, this explanation does not seem valid in the light of the Legal Profession Practice Act (Vic) 1958. Under the Act the courts may be inclined to treat the purpose for which a shelf company was formed as relevant to the question of whether the legal work involved in incorporating and converting the shelf company was done for reward. The 'principal activities' question on the Australian Securities Commission form 201 is strong evidence of that purpose. One would expect that the answer 'shelf company' is given in most instances by shelf organisations incorporating companies to be shelf companies. Where a shelf organisation is in the business of supplying shelf companies to clients, it seems clear that a company set up as a shelf company is set up to form part of the shelf organisation's 'stock'. Thus the reason for the preparation of legal documents is explained by the profit motive: stock is sold for profit.

SECRET COMMISSIONS

Although this article is primarily concerned with the consequences arising from the setting up of companies, trusts or funds using shelf organisations as such, some activities of certain shelf organisations warrant further comment.

These shelf organisations offer incentives such as free travel and accommodation to accountants who acquire a certain amount of their products. They do not warn the accountant that taking an incentive without disclosing the fact to his or her client can amount to taking a secret commission – an indictable offence (i.e. more serious than a summary offence) under both the Commonwealth and Victorian Crimes Acts.[11]

An accountant's failure to use or recommend a qualified person to draw up documents would be sufficient grounds for the client to win a negligence action.

CONCLUSION

Recently, complaints about the high costs of justice have led to considerable investigation at government level into the monopoly of legal practitioners on certain types of work.[12]

Regardless of the merits of breaking the legal practitioners' monopoly on such work as routine conveyancing, it must be realised that the drawing up of trust and superannuation documents is among the more complex of legal tasks. Even if it is true that once a complex document has been drawn up it becomes a standard precedent which can be used again, there are risks in implementing these documents without the involvement of a professional who understands them.

The wide acceptance of shelf organi-

sations in the provision of shelf companies is due to the ability of shelf organisations to provide a satisfactory secretarial service beyond that which legal practitioners have traditionally been willing or able to provide. But, with the onset of computers which can largely automate the secretarial aspects of providing shelf companies, it is expedient to consider whether shelf organisations should retain their bridgehead into this area of legal work which they have traditionally dominated.

There is a strong case for shelf organisations retaining their bridgehead, although, as stated in this article, this bridgehead is not recognised under law or professional ethics.

However, the case for retention is weakened if shelf organisations persist in offering trust deed and superannuation fund deed services and in offering secret commissions and using other invidious marketing techniques.

Furthermore, if shelf organisations are to be allowed to compete with lawyers, their marketing of legal services should be restrained in line with Rule 2 of the Solicitors (Professional Conduct and Practice) Rules (Vic) 1984[15] or whatever rules regulate legal marketing.

There is a significantly increased possibility of error and financial loss where the person 'selling' a legal document to a client or implementing it for a client does not thoroughly understand the contents and ramifications of the document. For example, the incorrect specifications in a discretionary trust deed of the settlement, the trust powers, the perpetuity period or the beneficiaries may provide tax auditors, creditors and others with opportunities to succeed in a wide range of claims against beneficiaries which would not have arisen had the trust deed been drawn up correctly. These kinds of errors occur regularly where the person who draws the document does not understand it. Examples of cases in which the Commissioners of Taxation have successfully attacked badly drawn up trust deeds that have come before the courts and the Administrative Appeals Tribunal include *Madner v Commissioner of Taxation*,[14] Case W12,[15] Case W15,[16] Case W21[17] and Case Y30.[18]

Even if readers of this article are unconvinced by the foregoing part of this conclusion, it is still true that accountants and their clients are taking avoidable risks in the light of the law and ethics canvassed in this article by using shelf organisations to obtain companies, trusts or funds.

These risks will remain unless qualified persons are engaged, or laws and ethics are changed through the appropriate processes to allow for unqualified persons to do this type of work. If this happened the community would probably demand extra consumer protection corresponding with the responsibility those unqualified persons should bear. The point is strongly put by Mr Gordon Hughes, president of the Law Institute of Victoria (as he then was) as follows:

"It is illogical and unacceptable to suggest that legal services should ever be provided by people other than properly qualified persons. Regulation is essential to ensure that such qualifications exist and the standards which give meaning to the qualifications are observed."[19]

Finally, a reference to Murphy's Law (the one which suggests that if something can go wrong it will) is apt when considering setting up a company, trust or fund using documents drawn by an unqualified person: Would an accountant's client really want to save $150 in costs if it meant that something could go wrong with the structural foundation of a $2 million investment?

David Garde is a tax lawyer with Jerrard & Stuk, solicitors and consultants, Melbourne.

REFERENCES

1 *Australian Accountant* July 1986 at p 38 and also in *Taxation in Australia* Dec-Jan 1985-6 at p 384.

2 (1984) WAR 101.

3 (1985) 16 ATR 115.

4 Other States and Territories have not given the various law societies equivalent statutory powers. However, these persons could be prevented from practising by the courts on application. See, for instance, section 48M of the Legal Profession Act (NSW) 1987 and section 192 of the Legal Practitioners Act (ACT) 1970. In Western Australia, a continuing offence can be dealt with as a contempt of court.

5 Related provisions can be found in the Legal Practitioners Act (NSW) 1987 subsections 40C to 40E, the Legal Practitioners Act (SA) 1981 section 21, the Law Society Act (Qld) 1952 sections 39 and 102, the Legal Practitioners Act (WA) 1893 sections 76-81, the Legal Practitioners Act (Tas) 1959 section 95, the Legal Practitioners Act (NT) 1974 sections 131-134, the Legal Practitioners Act (ACT) 1970 sections 122-125.

6 (1989) VR 43.

7 At p 48.

8 See sections 11,12 and 17, of the Fair Trading Act (Vic) 1985, the Fair Trading Act (NSW) 1987 sections 42, 44 and 50, the Fair Trading Act (SA) 1987 sections 56, 58 and 64, the Fair Trading Act (QLD) 1989 sections 38, 40 and 45, the Fair Trading Act (WA) 1987 sections 10, 12, 13, and 18, the Fair Trading Act (TAS) 1990 sections 14, 16 and 21, the Consumer Affairs and Fair Trading Act (NT) 1990 sections 42, 44 and 48, the Fair Trading Act (ACT) 1992 sections 12, 14 and 20.

9 The solicitors' insurers in other States and Territories have not adopted this type of specific exclusion. However, if a solicitor in NSW or the ACT assisted an unlicensed conveyancer in breach of the Conveyancers Licensing Act (NSW) 1992, then, according to the managing director of the Law Cover Scheme, the solicitor would be indemnified if a claim was made as a result of the transaction undertaken by the unlicensed conveyancer. (The assistance of the State and Territory Law Societies in providing this information is gratefully acknowledged.)

10 As provided by Marsh McLennan Pty Ltd.

11 Secret commissions are also prohibited for chartered accountants under the Institute of Chartered Accountants Rules of Ethical Conduct REC 1/26.

12 For example, the Senate Cost of Justice Inquiry, Report and Discussions Papers 1992 'Access to the Law: Restrictions of Legal Practice', Report of the Law Reform Commission of Victoria, 1992.

13 This presently provides, *inter alia*, that practitioners are prevented from advertising that they are specialists and that the Law Institute Council can supervise "undesirable" advertising.

14 Unreported, case heard before Ryan J of the Federal Court. Also noted by Mrs A Moshinsky QC in her article 'Discretionary Trusts Practical Legal and Tax Issues', *Taxation in Australia*, Feb 1990 at p 464 at p 466.

15 (1989) 89 ATC 190.

16 (1989) 89 ATC 204.

17 (1989) 89 ATC 242.

18 (1991) 91 ATC 306.

19 *The Law Institute Journal*, August 1992, p 653.