Corporate Essentials

Tax Smart Australia

Issue
#0112

Tax Essentials

Asset Protection (Safeguarding Your Future)

AUGUST	2021

THE NEWSLETTER
Tax Update – Impact on Small Business

MICHAEL'S CORNER
Article No.12
How Training And Development Assists Your Employees As An Asset

EXTRA EDITION – YEAR END TAX PLANNING TIPS
Clarifying the Process of Year End Tax Planning

SPECIAL BONUS ISSUE
Asset Protection 2021 (Safeguarding Your Future)

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TAX AND JOB CREATION MEASURES TO APPLY FROM 1.7.2021

These measures aim to provide tax relief, incentivise businesses to invest and ensure our superannuation system is more effective.

Retaining the low-and middle-income tax offset

The Government has extended further personal income tax cuts to support more than 10 million low and middle-income earners. These tax cuts are worth up to $1,080 for individuals or up to $2,160 for couples. This is more money to spend in local businesses, giving them the confidence to take on an extra worker, offer an extra shift or buy a new piece of equipment.

Providing tax incentives for businesses

The Government is further supporting businesses by extending its temporary full expensing and temporary loss carry-back measures beyond this financial year.

This will allow more than 99 per cent of businesses employing 11.5 million Australians to deduct the full cost of eligible depreciable assets of any value in the year they are installed until 30 June 2023.

These measures are estimated to boost GDP by around $7.5 billion in 2021-22 alone and create around 60,000 jobs by the end of 2022-23.

Cutting taxes for small and medium businesses

The tax rate for small and medium companies with turnover below $50 million will decrease from 26 per cent to 25 per cent. For a small unincorporated business such as sole traders, the tax discount rate will increase from 13 per cent to 16 per cent (up to the existing cap of $1,000). Access to a range of small business tax concessions will also be expanded with the turnover threshold rising from $10 million to $50 million, providing tax relief and reducing red tape for eligible businesses.

Supporting business research and development

Reforms to the Research and Development Tax Incentive take effect from 1 July. This includes generous tax offset rates above the company tax rate and includes an intensity test to reward companies that commit a more significant proportion of their expenditure to R&D. In addition, the cap on eligible R&D expenditure will rise from $100 million to $150 million per annum.

Providing tax relief for small brewers and distillers

As announced in the 2021-22 Budget, the Excise remission scheme for alcohol manufacturers will provide brewers and distillers with full remission of any excise they pay, up to an annual cap of $350,000.

This builds on the Government's 2020 21 MYEFO announcement to automatically allow eligible alcohol manufacturers to automatically receive their excise duty remission, reducing administrative overheads and providing additional assistance by addressing cash flow concerns. These changes also commence from 1 July.

Exempting granny flat arrangements from capital gains tax (CGT)

The Government is supporting older and disabled Australians and their families by providing a targeted CGT exemption for granny flat arrangements. From 1 July, CGT will not apply to the creation, variation or termination of formal written granny flat arrangements providing accommodation for older Australians or people with disabilities.

This change removes the CGT impediments to families entering into legally enforceable granny flat arrangements, reducing the risk of financial abuse to vulnerable Australians.

Supporting first home buyers and single-parent families

From 1 July, the Government will release an additional 30,000 places to eligible applicants under the First Home Loan Deposit Scheme, the New Home Guarantee Program, and the Family Home Guarantee.

As announced in the 2021-22 Budget, the Government will establish the Family Home Guarantee to support single parents with dependants. From 1 July, 10,000 guarantees will be made available to eligible single-parent families to build a new home or purchase an existing home with a deposit of as little as 2 per cent.

The Government will also extend the New Home Guarantee for a second year, providing an additional 10,000 places in 2021-22 for first homebuyers seeking to build a new home or purchase a newly built home with a deposit of 5 per cent.

Making superannuation work harder for Australians

As part of the most significant changes to superannuation in nearly 30 years, the Government is holding underperforming funds to account and strengthening protections for the retirement savings of millions of Australians.

The Government will require superannuation products to meet an annual objective performance test. Funds with products that fail the test will be required to inform members, while persistently underperforming products will be prevented from taking on new members. Members will be notified by 1 October 2021 if their product fails this test.

Australians will also have access to a single, trusted, and independent source of information to compare superannuation products through a new interactive online YourSuper comparison tool from 1 July. In addition, trustees will be required to demonstrate how their actions are in the best financial interest of members.

The Your Future, Your Super reforms are estimated to save Australian workers $17.9 billion over ten years.

Increasing flexibility for self-managed superannuation funds

The Government is providing Australians with more flexibility and control in managing their retirement savings. From 1 July, the maximum number of allowable members in self-managed superannuation funds and small APRA funds will increase from four to six.

Extending the temporary reduction in superannuation minimum drawdown rates

As part of the Government's COVID-19 response, the superannuation minimum drawdown rates were reduced by 50 per cent for the 2019-20 and 2020-21 income years. To further support retirees and provide extra flexibility, the Government has recently extended the temporary reduction to the 2021-22 income year.

Implementing Financial Services Royal Commission recommendations

Consumers will continue benefitting from the Government's strong record on implementing recommendations of the Hayne Royal Commission, with several reforms taking effect from 1 July.

A new independent body, the Financial Regulator Assessment Authority, will be established to review and report on the effectiveness and capability of the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.

The enhanced framework around providing financial advice to clients under ongoing fee arrangements starts to address the Royal Commission's concerns about fees for no service. To assist with this transition, the Government has recently made a regulation to lower compliance costs for generating fee disclosure statements. There is also a new disclosure obligation to ensure financial advisers who are not 'independent' provide clients with a clear and concise written disclaimer.

In the area of superannuation, there are new measures to prohibit the deduction of ongoing advice fees from MySuper products and to increase the transparency of fees to members. There is a new measure prohibiting superannuation trustees from having a duty to act in the interests of another except those arising from its role as trustee to address concerns about conflict. The Royal Commission recommendation that individuals be 'stapled' to a single super account has passed the parliament and will commence on 1 November 2021.

Cutting Cross-Border Red Tape for Tradies and Skilled Workers

Automatic mutual recognition (AMR) of occupational licences comes into effect across New South Wales, Victoria, the Australian Capital Territory, and the Northern Territory. This will enable licensed workers, including plumbers, builders, and architects, to operate across jurisdictions without applying, paying for, and waiting for a further licence to perform the same type of work in another state or territory. These measures, which will be implemented progressively, will provide a $2.4 billion boost to the economy, and directly benefit over 168,000 workers each year. Other states are expected to join the scheme subject to the passage of legislation.

Extending the Junior Minerals Exploration Incentive (JMEI)

The Government is extending the JMEI by four years to incentivise new investment in small minerals exploration companies undertaking greenfields minerals exploration in Australia.

Balancing the rights of franchisors and franchisees

Significant changes to the Franchising Code of Conduct commenced on 1.7.2021. This includes reforms to balance franchisors and franchisees' rights and improve access to justice through additional, more efficient dispute resolution processes.

Improving payment times for suppliers in government contract supply chains

From 1 July 2021, large businesses awarded government contracts valued above $4 million will be required to pay their suppliers with subcontracts of up to $1 million within 20 calendar days or pay interest.

Rolling out the Consumer Data Right

Starting from 1 July 2021 — exactly 12 months after the big four banks — the rollout of Open Banking by the remaining banks is set to occur. This means that even more Australians will now securely access and share their banking data to access better value products and services.

Introducing licencing obligations for debt management services

From 1 July, providers of debt management services will be required to hold an Australian credit licence and meet ongoing obligations imposed on licensees. These regulations form part of the Government's consumer credit reforms.

GST TIPS THIS TAX TIME AND GETTING IT RIGHT

When you give your work to the accountant this year, consider the following:

- Check for missed GST credits on purchases you have claimed income tax deductions on – a four-year time limit applies for claiming GST credits. This may occur if you occasionally use a personal account or credit card to make business acquisitions.
- Ensure you are registered for GST if required and backdate if needed. You need to register if:
  - Your enterprise meets the GST turnover threshold ($75,000)
  - A hobby has become a business
  - You are a ride-sourcing driver who needs to be registered regardless of turnover.
- If you are renovating houses for sale or developing and selling property for a profit, you may be running an enterprise and should be registered for GST, even for one-off sales.
- Make sure you are using the most suitable accounting method to meet your business needs. Ask whether the accrual or cash methods are suitable.
- Check that stimulus vouchers are accounted for correctly, where you have participated in a government voucher subsidy program.

If you are in the pay as you go (PAYG) instalment system, it is important to lodge your outstanding activity statements before lodging your tax return, so your tax assessment accounts for instalments paid throughout the year.

JUNE 2021 – MAN COPS CRIMINAL RECORD FOR FALSE WRE CLAIMS

A finance and IT manager who made false work-related expense claims in his income tax returns has been convicted and fined at the Southport Magistrates Court.

Mr Gavin Crosswell claimed 'other work-related expenses' totalling $86,229 and $79,472 respectively in his 2016 and 2017 tax returns.

The ATO systems immediately flagged that the claims were unusually high for someone of his income and occupation. But he ignored the real-time warnings asking him to double-check his claims and proceeded to lodge them.

When the ATO commenced an audit, Mr Crosswell took it a step further by submitting a voluntary disclosure form increasing his 'other work-related expenses' in the 2016 tax return to $104,837. In doing so, he attempted to claim an additional $18,608 of work-related expenses.

Mr Crosswell provided 47 invoices and eight bank statements in an attempt to substantiate his claims, but checks proved they were false or altered. He had not incurred the expenses relating to 46 of the invoices, and the remaining invoice was for private expenses.

As well as 58 criminal convictions being permanently entered on his record, he was fined $4,000 and ordered to pay $75,000 to the Commissioner, plus court costs.

If you have a criminal record, you may have to declare it to authorities and employers. It may impact your ability to:

- volunteer
- work with children
- apply for insurance
- obtain travel visas.

These convictions will also go against you if you are ever before a court again.

The ATO has timed this media release to urge the public to double-check their claims this tax time and not make excessive and untrue claims.

CONSULTATION ON THE PATENT BOX

The Federal Government announced a new patent box as a part of the 2021-22 Budget.

On 5.7.2021, the Government released a discussion paper on the design of the patent box, which will start on 1 July 2022.

Under the patent box, income earned from new patents that have been developed in Australia will be taxed at a concessional rate of 17 per cent.

Initially, the patent box will apply to the medical and biotech sectors.

Patent boxes are widely used in other jurisdictions, including the UK, France, Switzerland, and Singapore.

By providing internationally competitive tax treatment, the patent box will encourage the retention of Australian developed inventions in Australia.

The patent box will also encourage research and development in the medical and biotechnology sectors and complements the substantial support the Government already provides to innovative sectors through the Research and Development Tax Incentive.

The discussion paper also seeks views on whether the patent box would effectively support low emissions technologies.

The paper is available on the Treasury website and will be open for submissions for six weeks until 13 August 2021.

The Government will then consult on exposure draft legislation for the patent box prior to introducing legislation into the Parliament.

USING TECHNOLOGY TO HOLD MEETINGS, SIGN AND SEND DOCUMENTS

On 25.6.2021, the Morrison Government has released exposure draft legislation to support companies and their officers using technology to satisfy Corporations Act 2001 requirements. Specifically, this legislation will facilitate technology in meetings, execute company documents, and send meeting-related materials.

These reforms make permanent the temporary measures put in place during the COVID-19 pandemic relating to the electronic execution of company documents and meeting notifications, which received overwhelming stakeholder support.

Building on the reforms to facilitate the use of technology in meetings, the exposure draft will also:

- make it clear that companies can hold hybrid meetings.
- make it clear that members, as a whole, must be given a reasonable opportunity to participate in meetings whether the meeting is a physical meeting, a hybrid meeting, or a virtual meeting.
- ensure that using a show-of-hands is the default method for voting at both physical and hybrid meetings; and
- allow members who hold at least 5 per cent of voting capital to have polls independently scrutinised.

These changes will provide shareholders with enhanced opportunities to both participate in and scrutinise company meetings.

The exposure draft legislation also includes further reforms to modernise business communications. This reform allows sole directors who are not appointed as the company secretary to execute documents electronically, delivering on a commitment under the Government's deregulation agenda to improve the technology neutrality of Treasury portfolio laws.

SUPER FOR CONTRACTORS

This issue never goes away and certainly has hurt some employees after superannuation guarantee audits. In June, the ATO released a fact sheet on this topic.

If you pay contractors mainly for their labour, they are employees for superannuation guarantee (SG) purposes, and you may need to pay super to a fund for them.

It does not matter if the contractor has an Australian business number (ABN).

Super contributions for contractors

Make super contributions for contractors if you pay them:

- under a verbal or written contract that is mainly for their labour (more than half the dollar value of the contract is for their labour)

- for their personal labour and skills (payment is not dependent on achieving a specified result)
- to perform the contract work (work cannot be delegated to someone else).

Example: employee for super guarantee purposes, not a contractor

David's Caravan Park has a contract with Amanda, a freelance administrative assistant, to answer phones and do administrative work for 15 hours per week.

The contract specifies that Amanda herself must perform the work. Amanda has an ABN and invoices David's Caravan Park weekly for the hours she works. Amanda is an employee for SG purposes because:

- her contract is wholly for the labour and skills she provides
- she is paid according to the number of hours worked
- she performs the work herself.

Assuming that Amanda is paid at least $450 per month, David's Caravan Park pays SG contributions for her in addition to her pay.

If you enter into a contract with a company, trust, or partnership, you do not have to pay super for the person they employ to do the work.

Example: contractor, not employee for super guarantee purposes

Harry's Hobby Shop wants to paint their new shop. They contract Pete's Paints for the job. One painter from Pete's Paints completes the entire job.

- The contract is between Harry's Hobby Shop and Pete's Paints.
- Harry's Hobby Shop paid Pete's Paints to achieve a result.
- The painter is not an employee of Harry's Hobby Shop for SG purposes.

Harry's Hobby Shop does not have any SG obligations for the painter or Pete's Paints. This is the case even if Pete is a sole trader and does the work himself because he was contracted to achieve a result.

Pete's Paints may have SG obligations for the painter.

How much super to pay for contractors

The minimum super you must pay is the super guarantee percentage (from 1.7.2021, 10%) of the worker's ordinary time earnings. This is the labour component of the contract. Do not include:

- any contract payments that are for material and equipment
- overtime for which the worker was paid overtime rates
- GST.

If the values of the different parts of the contract are not detailed in the contract, the ATO will accept their market values and consider standard industry practices. If you cannot work out the contract's labour part, you can use a reasonable market value of the labour section.

Paying an additional amount equal to the SG rate to the contractor on top of their usual pay does not count as a super contribution. To avoid the super guarantee charge, you must make the SG contribution to the contractor's super fund each quarter.

The ATO website contains valuable additional information.

SIMPLIFIED TRADING STOCK RULES

You can use the simplified trading stock rules if you:

- are a small business with an aggregated turnover of less than $10 million a year (or from 1 July 2021, with an aggregated turnover of less than $50 million a year)
- estimate that the value of your trading stock changed by less than $5,000 in the year.

If you use simplified rules, you do not have to:

- conduct a formal stocktake
- account for the changes in your trading stock's value.

ATO WARNS ON 'COPY/PASTING' CLAIMS

The ATO is alerting taxpayers that its sights are set on work-related expenses like car and travel claims predicted to decrease in this year's tax returns.

Overall, around 8.5 million Australians claimed nearly $19.4 billion in work-related expenses in their 2020 tax returns.

Assistant Commissioner Tim Loh noted that COVID-19 has changed people's work habits, so we expect their work-related expenses to reflect this.

"We know many people started working from home during COVID-19, so a jump in these claims is expected," Mr Loh said.

"But, if you are working at home, we would not expect to see claims for travelling between worksites, laundering uniforms or business trips."

Last year, the value of car and travel expenses decreased by nearly 5.5%. However, there was a slight increase of around 2.6% in clothing expenses. With uniform and laundry claims significantly lower, this increase was driven by frontline workers' first-time need for things like hand sanitiser and face masks.

According to Mr Loh

- While it's good to see most people have been doing the right thing, ATO data analytics will be on the lookout for unusually high claims this tax time. Particularly where someone's deductions are much higher than others with a similar job and income.
- The ATO will also look closely at anyone with significant working from home expenses that maintains or increases their claims for things like car, travel, or clothing expenses.
- You can't simply copy and paste previous year's claims without evidence.
- But the ATO is aware some of these unusual claims may be legitimate. If you explain your claim with evidence, there is nothing to fear.
- The ATO also wants to reassure the community that they will be sympathetic to legitimate mistakes where good faith efforts have been made. However, where people are detected deliberately claiming things they are not entitled to, firm action will be taken.

During 2020, the ATO had to shift focus on getting stimulus benefits out the door as quickly as possible to support so many businesses in need.

In 2021, the ATO will be continuing to balance its role in supporting taxpayers through this very challenging time while recommencing its focus on addressing overclaiming of work-related expenses.

How COVID-19 has changed work-related expenses

Working from home expenses

The temporary shortcut method for working from home expenses is available for the full 2020-21 financial year. This allows an all-inclusive rate of 80 cents per hour for every hour people work from home, rather than separately calculating costs for specific expenses.

All you need to do is multiply the hours worked at home by 80 cents, keeping a record such as a timesheet, roster, or diary entry showing the hours you worked.

Remember – the shortcut method is temporary. If you want to claim part of an expense over $300 (such as a desk or computer) in future years, you need to keep your receipt.

Personal protective equipment (PPE)

Suppose your specific duties require physical contact or close proximity to customers or clients, or your job involves cleaning premises. In that case, you may be able to claim items such as gloves, face masks, sanitiser, or anti-bacterial spray.

This includes industries like healthcare, cleaning, aviation, hair and beauty, retail, and hospitality.

To claim your PPE, you will need to have purchased the item for use at work, paid for it yourself, and not been reimbursed. You also need a record to support your claim – a receipt is best.

Clothing and laundry, self-education, car, and travel expenses

In 2020, the ATO saw a decrease in the value of work-related expenses for cars, travel, non-PPE clothing, and self-education due to the introduction of travel restrictions and limits on the number of people who could gather in groups. The ATO expects this trend to continue in the 2021 tax returns.

If an employee is working from home due to COVID-19 but needs to travel to their regular office sometimes, they cannot claim the cost of travel from home to work as these are still private expenses.

Case study – overclaiming work-related expenses

A Canberra administrative worker fraudulently received nearly $7,000 in refunds after claiming work-related car, travel, clothing, and self-education expenses he wasn't entitled to. He had his fraudulent claims knocked back in 2014 after he couldn't provide any receipts, instructing the ATO to "just process the return". He tried it on again in his 2015 and 2016 returns, this time providing a fake letter from his employer.

Given the brazen and repetitive nature of the fraud, the taxpayer was prosecuted and now has a criminal record. He was also fined $1,800.

SUPPORTING RETIREES WITH EXTENSION OF THE TEMPORARY REDUCTION IN SUPERANNUATION MINIMUM DRAWDOWN RATES

On 29.5.2021, the Federal Government announced an extension of the temporary reduction in superannuation minimum drawdown rates for a further year to 30 June 2022.

As part of the response to the coronavirus pandemic, the Government responded immediately. It reduced the superannuation minimum drawdown rates by 50 per cent for the 2019-20- and 2020-21-income years, ending on 30 June 2021.

The announcement extends that reduction to the 2021-22 income year and continues to make life easier for our retirees by giving them more flexibility and choice in their retirement.

For many retirees, the significant losses in financial markets as a result of the COVID-19 crisis are still having a negative effect on the account balance of their superannuation pension.

This extension builds on the additional flexibility announced in the 2021-22 Budget.

The Federal Government will continue to support retirees as part of their plan to secure Australia's economic recovery from COVID-19.

SUPER GUARANTEE RATE RISING 1 JULY

On 1 July 2021, the super guarantee rate will rose from 9.5% to 10%. If you have employees, you will need to ensure your payroll and accounting systems are updated to incorporate the increase to the super rate.

The super rate is scheduled to progressively increase to 12% by July 2025.

VIRGIN AUSTRALIA AIRLINES PTY LTD V COMMISSIONER OF TAXATION [2021] FCA 523

This Federal Court case held that Virgin did not provide car parking fringe benefits to its flight and cabin crew at Sydney, Brisbane, or Perth airport. The reasoning being the flight and cabin crew's primary place of employment was the aircraft where they operated, only on one aircraft on a particular day, or where they operated on more than one aircraft involved on a particular day, there was no primary place of employment. The airport car parks were not in the vicinity of the aircraft.

MUSSALLI V COMMISSIONER OF TAXATION [2021] FCAFC 71

This Full Federal Court case has held that the upfront payments to secure a rent reduction under long-term leases were to obtain a more profitable business structure. Thus, the payments were on capital account and not deductible under s 8-1 of the ITAA 1997.

NEW R&D TAX INCENTIVE CUSTOMER PORTAL

The ATO has advised a new customer portal (https://incentives.business.gov.au/) has been launched to make it easier for companies to manage their applications for the Research and Development (R&D) tax incentive.

This facility has been available since 5.7.2021.

The portal includes:

- an online space for you, and your authorised representatives, to manage your company's interactions with the R&D tax incentive program
- an updated application form - making it more straightforward for you to understand the eligibility criteria and how to address these in your application
- improved security using myGovID digital identity services, linked to your company's ABN using Relationship Authorisation Manager (RAM).

In the future, you'll also be able to use the portal to apply for and manage your Advance and Overseas Finding applications, request to withdraw or vary your R&D tax incentive application, apply for an extension of time, and even check the status of your submitted applications.

The new customer portal help and support page includes videos to help you access and complete your application, including a walk-through of the portal.

COLLECTABLES AND PERSONAL USE ASSETS (SMSFS)

This issue comes up time and again for SMSFs with trustees/members wanting to invest in collectables and personal use assets, including:

- artworks
- jewellery
- vehicles
- boats
- wine

Investments in such items must be made for genuine retirement purposes, not to provide any present-day benefit.

Collectables and personal use assets can't be:

- leased to, or part of a lease arrangement with, a related party
- used by a related party
- stored or displayed in a private residence of a related party.

In addition:

- your investment must comply with all other relevant investment restrictions, including the sole purpose test
- the decision on where the item is stored must be documented (for example, in the minutes of a meeting of trustees), and the written record kept
- the item must be insured in the fund's name within seven days of the fund acquiring it
- if the item is transferred to a related party, this must be at market price as determined by a qualified, independent valuer
- as with all fund assets, check prior to purchase that they are not encumbered in any way (you can use the Australian Financial Security Authority's Personal Properties Security Register to ensure that collectables and personal use assets have no security interests over them prior to your purchase).

For collectables and personal use assets you held before 1 July 2011, you had until 30 June 2016 to comply with these rules.

G7 NATIONS AGREE ON 15 PER CENT GLOBAL TAX RATE FOR MULTINATIONAL COMPANIES

The G7 nations have reached a landmark deal to pursue higher global taxation on multinational businesses such as Google, Apple, and Amazon.

The group of Seven large, advanced economies, including the United States and the United Kingdom, have agreed to back a minimum global corporate rate of at least 15 per cent and for companies to pay more tax in the markets where they sell goods and services.

The deal means hundreds of billions of dollars could flow into the coffers of G7 governments left cash strapped by the Covid-19 pandemic.

The deal sealed after years of negotiation aims to end national digital services taxes levied by Britain and other European countries that the United States considered unfair to US technology giants.

These measures will still need to be ratified at a meeting of the G20 – which includes the emerging economies – due to take place in July in Venice.

For some years, G7 nations have been unable to agree on the way to raise more revenue from the likes of Google, Amazon, and Facebook. These large multinationals often book profits in jurisdictions where they pay little or no tax.

The Joe Biden administration paved the way fresh by proposing a minimum global corporation tax rate of 15 per cent.

While Germany and France have welcomed the agreement, French Finance Minister Bruno Le Maire wants a higher global minimum corporate tax rate than 15 per cent, which he has described as a "starting point".

The tax proposal will allow countries to tax a share of the profits earned by companies with no physical presence but have substantial sales, such as selling digital advertising.

The G7 nations will then tax their home companies' overseas profits at a rate of at least 15 per cent.

This aims to prevent accounting schemes from shifting profits to a few very low-tax countries because earnings untaxed overseas would face a top-up tax in the headquarters country.

bO2 READERS QUESTIONS AND ANSWERS.............

Question 1
Subject: Deed of Settlement

Scenario:

In 1983 Client A purchased a commercial property (ACT leasehold) in the ACT, which contained several commercial premises.

A substantial portion of the land was still vacant and available for further development.

In 2002 the whole property was sold to another party (Party B). However, Client A retained one of the commercial rental premises (rented to a third party) under the deed of trust pending the development of the vacant portion of the parcel of land and subsequent strata titling of the whole property.

Once the property was strata-titled, the retained commercial premises were returned to Client A for $1.00.

To date, this has not occurred, notwithstanding the demands made by Client A for this to be completed.

The property can no longer be strata-titled due to the long delay by Party B in lodging the appropriate application with the ACT Government.

As a result, Client A can no longer obtain possession of its commercial rental property.

Legal processes have now resulted in a deed of arrangement wherein Client A will be paid a yet to be determined amount as settlement for forging its right to the commercial property.

Client A has continued renting the commercial premises under the original deed of trust up to this point in time.

Whilst Client A did not have legal title of the commercial premises other than a deed of trust are the following assumptions correct:

• The proceeds of the deed of settlement are not subject to CGT, given the original purchase occurred in 1983.

• The pending settlement is not subject to GST given that the “sale” is a going concern with the commercial tenant in place.

Note Client A is registered for GST?

Answer

Given that the A.C.T. has unique property title considerations and the complexity of this matter, we decline to give general advice.

While we accept that, in all likelihood, you have done an excellent job in summarising the matter. We need to know the full facts and circumstances.

Even if this were available, we would recommend seeking legal advice, or at the very least, an application be made for a private ruling.

Question 2

Subject: Request Advice

My client owns an old house on a large block. They intend to level the building and build two new units, which will be rented purely as a profit-making venture. Do you believe that the venture should be carried out through a discretionary trust? If not, please provide your alternative.

Answer

On the face of it, a discretionary trust has merits.

It allows asset protection along with flexibility as to who receives the income for taxation purposes.

Income retains its character as it flows through the Trust. If a valid income distribution is made each year, the relevant individuals will be assessable on their share of income at their marginal tax rate.

A trust allows some perpetuity in that the corporate trustee will retain ownership after key individuals pass away.

You may wish to check with your client if holding the asset in a trust suits their estate planning requirements.

Question 3

Subject: Is CGT Applicable

Facts:

- The property was purchased on December 11, 2006.
- The cost of purchasing the property with her husband is $465,654.
- June 12, 2012, separated from husband.
- June 1, 2013, rented out the property and moved to a rented unit.
- July 1, 2013, divorce was finalised.
- February 1, 2015, refinanced the house with a new bank and an additional $95,000.00 was borrowed and given to the ex-husband.
- October 26, 2019, the house sold for $1,180,000.00 less costs of $ 10,368.00.

We believe that the six-year rule should apply due to the circumstances of the case, and no CGT will apply. Would you look at the issue and confirm whether we are correct in our conclusion or **CGT will apply**?

If CGT applies, appraisal of the property from a reputable realtor valued it between $770,000 and $800,000 at the date she moved out.

Do we calculate the CGT on the difference between the sale price and valuation and apply the 50% balance?

Answer

The best outcome would be to apply for a 6-year temporary absence.

The taxpayer did not have any other principal place of residence (PPR) allowing this.

It is not necessary to move back into the property to claim the six years.

Because this means for the period 11.12.2006 to 1.6.2019, the property qualifies as the PPR. This assumes the wife moved out of the property on 1.6.2013.

For the period 2.6.2019 to 26.10.2019, CGT applies.

As this is apportioned on a 'days of ownership' basis, this is, of course, a tiny percentage of the total ownership of 12 years, ten months.

After applying the 50% discount, very little CGT will be payable.

Question 4

Subject: Concessional Personal Contribution

My question is about catch-up contributions. I have been working the whole year round as a sole trader and have stopped contributing to superannuation for more than 20 years now. I will be 73 years of age this June.

I want to make a concessional personal contribution of $50,000.00 and claim this contribution against my taxable income. I have not contributed to superannuation for a long time. I believe I can contribute a total of $75,000. ($25,000 x 3 years).

Can I then withdraw the money three months later, say on September 22, 2021?

My second question is, is there a time limit as to when I can withdraw my contribution? And what would be the possible reason for withdrawal?

Answer

You need to meet a work test to make contributions into super as you are over 67 years of age.

The main issue to resolve is whether, in the last 12 months, you have worked 40 hours in any 30 consecutive days?

There is a one-off exemption for the work test if you have ceased work within 12 months of the contribution and have a total balance in superannuation of less than $300k.

If you are still eligible, we need to consider your proposal.

You are effectively talking about making catch-up contributions for 30.6.2019 and 2020 in 2021, making a total of $75k.

To be able to do this, your super fund balance must be less than $500k.

We take it you are aware there is a 15% tax on concessional contributions as they go into the fund.

There is no time limit as such, but you would be well advised to leave the contribution in the fund for at least a month and then have a reason for any lump sum withdrawal. It is improbable you would be required to provide a basis; it could be pressing and personal family matters etc.

Question 5

Subject: Changing Super Funds

At the age of 67, my Client's ABC super fund benefit, after being conservative balanced for 30 years, is equal to $ 450,000. Not being happy with the return compared with XYZ super fund, now wants to transfer to the XYZ super fund(or another one), believing that the returns will be better.

Can you please advise whether transferring to a new fund will have an advantage or disadvantage regarding insurance or any other matters (like tax or getting a pension later)?

Answer

First, if your client has invested with a conservative risk profile, they cannot expect high returns.

We wonder if this has been fully explained to them by a professional.

The characteristics of the contributions and end benefits and preservation will not change, and this will be part of the information supplied by ABC to the new fund.

There may be some insurance issues, though, and you need to check this out.

It is quite possible the premiums vis-a-vis the benefits payable to the member or their estate will be markedly different.

You will need to investigate this and proceed with caution.

It would be advisable to take advice from a reputable financial planner.

Regarding the pension, there were some grandfathered benefits several years ago that may need to be taken into account.

Question 6

Subject: SMSF Query

A Full Pension owns a commercial property, installed solar panels for $30,000. Can SMSF write it off at one go (as the legislation allows up to $150,000)?

Answer

Unfortunately, the answer is no, as the SMSF does not conduct a business.

Question 7

Subject: Non-Preserved - Roll Over to SMSF

We have a client aged 57, medically discharged from work on Work Cover with a state authority super scheme with a large portion of the fund having a restricted non-preserved amount.

Upon rollover, the specified non-preserved portion will change to unrestricted non-preserved once the Client provides medical documents showing he cannot work anymore.

The question is:

- If we set up a SMSF and transfer the total super balance, will there be any issues related to the restricted non-preserved amount?
- Will there be tax or any other issues when transferred to unrestricted from restricted non-preserved?
- Does it trigger a taxing event if transferred to the SMSF?
- I confirm it will just be a transfer, and the Client will not access any benefit until he is 60.
- We think there will be no tax payable, and when he is 60, he can set up a pension and receive tax-free.

Answer

1. There will be no change in the classification of the benefits due to the transfer between the superannuation funds.
2. When the classification of the benefits changes due to medical advice, there will be no tax issues within the SMSF.
3. The taxing event will be due to liquidation of benefits (to make the transfer) from the State Fund, and there will likely be capital gains tax issues. CGT is effectively 10% on assets held longer than 12 months… otherwise, 15% within a complying super fund.
4. Noted, and we mention in passing there may well be benefits in rolling over the permanent incapacity insurance to a SMSF.

Question 8

Subject: Anniversary of Traineeship?

I have a Certificate 3 trained educator for our pre-school. While employed as a trainee, we had to extend her traineeship by approximately 6mths because she could not get it done.

Is the anniversary date to go to the next level the date she started her traineeship or the date she finished training?

My payroll clerk has it as the day she started (this decision was not discussed). If this is not the case, can I change it to the date she completed her course after discussion with the employee?

Answer

The payroll person is correct by basing on when they left school, and it increments yearly on their anniversary whilst they are on a traineeship.

Nothing in the award impacts the fact the employee took an extra six months.

An apprenticeship is a different story.

Question 9

Subject: Business Sale – Employee Entitlements at Changeover

Upon sale of a business, is Long Service and Sick Leave calculation negotiable in QLD?

Recently, I was involved with a business acquisition in the construction industry where they calculated Long Service Leave on staff employed greater than five years and sick leave 100%. In NSW & Victoria, only 20 or 50% of total Sick Leave accrued; I could not find a fixed % for Qld.

Answer

If the new owner recognises the existing entitlements

When there is a transfer of business, a new employer must recognise an employee's service with the old employer when working out most of their entitlements, including:

- sick and carer's leave
- requests for flexible working arrangements
- parental leave.

However, there are some entitlements that the new employer might not have to recognise. These include:

- redundancy
- annual leave
- long service leave
- unfair dismissal
- notice of termination.

If they recognise service, then it is 100% there are no percentages.

Question 10

Subject: Family Trust Carry-Forward

A family trust has 100,000 carry-forward losses as at 30/6/2019. In 2020 the family trust had 100,000 profits.

My question is...

Can the family trust ignore the carry-forward losses, distribute the profit, including franking credits?

Answer

The carried forward losses are included in the calculation of taxable income.

The only argument for not including the losses would be if a valid family trust election (FTE) had not been done in 2019.

However, not having a valid FTE in place could endanger the franking credits if they are over $5,000.

To gain the benefit of the franking credit, everything should be done to ensure the Trust legitimately has a small taxable income in finalising the accounts, and this includes recognising revenue in 2020 or deferring expenses until 2021.

Question 11

Subject: Transfer Funds to Foreign Company

Company A was established in Australia and owned by foreign company B (100% ownership by ordinary shares: $600,000).

Company A used the fund of $600,000 to operate the business in Australia, and it made a total loss of $200k for two financial periods.

Company A decided to cease the operation in Australia. Company A currently has $400,000 in the bank because they have not spent all the initial funds.

Questions are:

1. How can the remaining balance be transferred to a foreign company (located in an overseas country) and the process/tax implications?
2. Are they any other points to consider when company A ceases to operate?

I want to clarify if:

- There will be no tax payable regarding the transfer of remained cash balance in Company **A** to foreign company **B**, which owns 100% of Australian company **A.** Is it correct?
- There will be no limitation of the above when transferring to a foreign company?

Answer

For company A...

It is crucial that the company's balance sheet be cleared and there are no assets or liabilities.

In particular, make sure no lodgements or amounts are outstanding with the ATO or ASIC.

Be sure that the company is facing no legal matters.

Prepare appropriate company minutes returning the shareholder funds to company B.

After the funds have been returned to Company B, fill out a form 6010 for ASIC to deregister the company.

The lodgement fee for this is $42.

On the form, the Director must make signed declarations relating to the above, so exercise due care.

The company has incurred tax losses – there is no tax payable on a return of capital to shareholders.

Question 12

Subject: Superannuation Guarantee

10% Superannuation Guarantee is payable effective July 1, 2021.

The various circulars we are receiving advocate that if the salary paid on July 21 for the period ended on or before 30/6/21, superannuation is still 10%.

Would this be true if we are paying Cash / Bank (Salary) against "Salary Payable", for which we have booked expenses before 30/6/21 for the salary?

My argument is, expenses booked in a period before 30/6/2021, Super should be 9.5%.

Please advise what the ruling around this is.

Answer

We understand the confusion, but for payments related to the June 30, 2021 (or earlier) quarter, the amount is definitely 9.5%.

Question 13

Subject: - Deceased Estate with Farm

We have a deceased estate with farm property Estate JH.

Under the will of his father, who died in 1959, JH was left the farm property under these clauses:

"I authorise my wife to continue for such period as she may desire the farming operations carried on by me on my death."

"On the death of my said wife, I direct that all the property of which my wife shall have had the use of during her life as aforesaid shall pass to my son JH."

The wife died in 1985.

For capital gains tax purposes, what is the date on which JH is deemed to have acquired the property?

Answer

We need to be very careful where the CGT issues are linked to the terms and conditions of a Will.

While we strongly suggest you speak to the client's lawyers, the relevant CGT dates will be linked to title transfers.

Establish whether a testamentary trust was created by the terms and conditions of the Will – take legal advice.

If so, was the title transferred to the testamentary trust?

Or was the title transferred to the wife?

Or is this an Estate of long standing that has not been settled?

It will be necessary to establish who has the current title and work back from there, taking legal advice.

Question 14

Subject: Residency of a Deceased Estate.

We have a question regarding the residency of a deceased estate.

Following are the facts regarding the estate:

1. The deceased was a non-resident of Australia (UK resident), lived in the UK since the 1960s.
2. The deceased owns 3 Property Units here in NSW, Australia. The properties were passed onto him under his brother's Will. The deceased filed his Australian tax returns as a non-resident and taxed at non-resident rates.
3. After death, the properties above formed part of the deceased's Australian estate.
4. The sole executor and trustee of the deceased's Australian estate is an Australian resident residing in Australia.
5. The estate's sole beneficiary is the deceased's spouse, also a non-resident (UK resident).

Given the above scenario, would you kindly advise the tax residency of the above deceased estate?

Answer

While we think this is a deceased estate for a UK resident, to be administered in accordance with the relevant legislation in the United Kingdom, you will need to take legal advice to confirm this.

The CGT issues on the disposal or transfer of the Australian units will be subject to Australian law.

A lawyer with Deceased Estate experience will need to review the Will.

Question 15

Subject: Top-Up Maternity Leave

We are current members & have a question regarding maternity leave & annual leave payments.

Is it possible for an employee to 'top-up' the maternity leave minimum wage payments with annual leave payments?

Answer:

The short answer is yes; they can.

As long as both the employer and employee agree, and a leave application is filled out.

Michael's Corner

Article No.12

HOW TRAINING AND DEVELOPMENT ASSISTS YOUR EMPLOYEES AS AN ASSET

When it comes to your businesses most valuable asset, a lot of areas come to mind. Customers, accounts, marketing, or even a patent might take the top spot. But that is not even close to your businesses most valuable asset. The answer is the five, tens, or hundreds of employees that make up your business's workforce.

In whatever way, degree, or manner, it's considered today the knowledge of employees and their productivity your businesses most valuable asset; remember, all of your intangible assets, such as patents, copyrights, intellectual property, brands, and trademarks, are created by people.

Therefore, people matter most to you and your business; they are the essential contributors to profits and value. That said, people are vital assets for any business. In today's continuously changing business world, human assets, not the fixed or tangible assets, differentiate a company from its competitors. The knowledge economy distinguishes one business from another.

Training is not just necessary to any company; it is vital.

Although there are many training categories such as management training and or sales training, employees with Project Management skills are an essential asset to any organisation.

But What Do Training and Development Mean To Your Organisation?

Training presents a prime opportunity to expand the knowledge base of all employees, but many employers in the current climate find development opportunities expensive. Employees attending training sessions also miss out on work time, which may delay the completion of projects. However, despite these potential drawbacks, training and development provide both the individual and organisations as a whole with benefits that make the cost and time a worthwhile investment. The return on investment from the training and development of employees is an undeniable choice.

Training can be of any kind relevant to the work or responsibilities of the individual and can be delivered by any appropriate method.

For example, it could include:

- On-the-job learning
- Mentoring schemes
- In-house training
- Individual study

How People Benefit Your Business

Employees champion your business and determine its success or failure. The work they do determines what customers, and the competition are. See, you need to treat your employees with the value they bring. Employees leading a business might be replaced physically, but their skillsets and knowledge cannot be. This is because each person hired brings a different set of skills to the table even though the job description may display the same skills.

Besides, the skillset of employees accounts for 85 per cent of a company's assets. Therefore, employee efficiency and talent determine the pace and growth of a business. We need to recognise the value of employees in the industry and praise them accordingly. This includes their knowledge, expertise, abilities, skillsets, and experience. These are all invaluable and intangible assets for securing a future for the business. So, when employees feel valued, they will gladly compete in the race and beat the competition.

Reasons Employees Are Considered Invaluable Assets

Essential to providing goods or services - Improving employee efficiency and performance are major priorities for any business. Employees produce the final product, take care of finances, promote your business, and maintain the decision-making records.

Employees are the first customer of any business - If the firm does not have happy and satisfied employees, they will not deliver performance-oriented results. Therefore, reducing the profits of the company.

Employees give their 100 per cent to any business - No matter what size the business is, success results from continuous strenuous and intelligent efforts put in by happy and valued employees. This results in keeping the company going, competing with its competitors, and elevating ahead of them all.

Employees are the face of a business - It's the satisfaction level of your employees that matters the most. So, if an employee is not happy, she might spread a negative word about the business, even after leaving it. What is more, an unhappy employee will lack motivation and will not perform well, leading to unsatisfactory performance. This results in unachievable performance targets, low profits, and employee churn.

They are the nurturers of the business - Employees are the ones who give their heart and soul to a company. Similar to how parents raise their children, employees nurture their business with their values and endless efforts to take it to the top.

Skilled people with knowledge - The most irreplaceable factors employees bring to the table are their skillsets. Their skills include training and development programs, experience in a specific field, and an understanding of workplace cultures, systems, and work procedures.

Employees are the base of a robust and long-running business - Employees run the business, no matter what level. This means their strength, commitment and dedication, and their emotional connection with the company cannot be judged as assets in monetary value.

Motivated employees make a significant difference - Employees reach new targets, meet customers' demands and needs, develop new and innovative products, and perform enormously considerable efforts to achieve the company's objectives.

Employees are significant contributors to the profits and worth of the business - This results in excellent customer reviews and creating brand loyalty from customers. Therefore, employees are the most valuable assets a company has. It is their abilities, knowledge, and experience that cannot be replaced.

Therefore, it is your job to invest in your employees by providing them with the best training and development that you can.

Please note that this is general advice for information only. Any application of legislation or Industrial Relations, or contractual requirements may require professional advice to suit your circumstances.

Want to know more about our HR/ IR Smart Guides, Smart ToolPacks, WHSmart Safety Essentials and other business-related online services.........
Call bO2 toll-free P 1300 555 533.

If you have questions for Michael's team, send us an email ... info@bo2.com.au

Your Notes

Special Bonus Issue

ASSET PROTECTION 2021 (Safeguarding Your Future)

WHAT'S NEW IN 2021?

- Working through the COVID-19 Crisis.
- An update on protecting the family home against creditors.
- How safe are funds in superannuation?
- Advising clients through the COVID crisis and recovery.
- Ensure your business is viable post-COVID-19.
- Bankruptcy and a potential inheritance.
- Trends in cryptocurrency.
- We are revisiting exposures for directors post-COVID-19.
- Updates to estate planning and bankruptcy.
- Making sure your COVID-19 balance sheet is accurate.

BINDING FINANCIAL AGREEMENTS

The *Family Law Act 1975 (Cth)(FLA)* allows parties in a relationship to enter into a binding financial agreement (BFA) to provide for how marital assets (including those assets brought to the association by the parties) are divided in the event of separation. A BFA can be drafted to account for specific assets in existence when the agreement is made and, or those acquired subsequent to the agreement.

Of course, broaching the subject of entering a BFA can be challenging. Although a BFA may not always be completely 'watertight', it will provide the parties with a level of certainty concerning the division and distribution of assets in the event of a relationship breakdown.

A BFA is binding on the parties to the agreement if:

- Both parties have signed the agreement.

Before signing the agreement, each party was given independent legal advice as to:

- The effect of the agreement on their rights.
- The advantages and disadvantages of entering into the BFA.
- Each spouse was provided with a signed statement stating that the advice was provided.

After signing, the original agreement is given to one of the parties and a copy given to the other (or their legal representatives), and

- The agreement has not been terminated and has not been set aside by a court.
- Parties entering into a compliant BFA enjoy the enduring benefit that the Family Court cannot make an order inconsistent with the terms of the agreement.

A BFA may be set aside by the Family Court if it is satisfied that:

- The agreement was obtained by fraud, including non-disclosure of material matters.
- The agreement is void, voidable or unenforceable.
- Circumstances arose since the agreement made it or a part of the agreement impracticable to be carried out.
- Since making the agreement, a material change in circumstances has occurred (being circumstances relating to the care, welfare, and development of a child of the marriage) and, as a result of the change, a party to the agreement will suffer hardship if the court does not set the agreement aside, or
- In respect of the making of a BFA – a party to the agreement engaged in conduct that was, in all the circumstances, unconscionable.

SO, YOU'VE BEEN ASKED TO SIT ON THE BOARD

Typically, this is an unlisted public company, and the expectations are that this could lead to a public listing in one to two years.

You have been sought out because you are a Lawyer, accountant or leading academic. In short, you and others are needed to give the board credibility to attract future investors. Typically, we have an entrepreneur who is aiming high, hands-on, and has an unshakeable self-belief… but never would we want to dampen the entrepreneurial spirit in any way – the cold hard facts are that less than 5% of these start-ups successfully achieve their objectives – some are wound up in an orderly fashion. In contrast, others fail spectacularly, owing creditors and staff substantial amounts of money.

Sometimes when this happens, the non-executive directors express genuine surprise. Often the board meetings had gone into a hiatus after initial positive meetings that spoke of limitless opportunities…

Telephone discussions with the charismatic entrepreneur revealed that although conditions were tight, future funding was assured, and there was no real cause for concern.

What should have happened?

Prior to accepting the appointment, you could have:

- Requested access to the company's corporate governance policy.
- Insisted on core inclusions on the agenda for the monthly board meetings.
- At the very least, these would have included monthly management accounts and summaries of cash balances, aged debtors (what is owed) and aged creditors (what the company owes).
- Copies of ATO portal balance establishing the position with company lodgements and debtors GST, PAYG, company tax and other liabilities.
- Sighting legal opinions and advice et al. giving a level of assurance as to ownership of patents, intellectual property, mining concessions and licences.
- Taking steps to understand exactly who you are dealing with – beware the entrepreneur well into middle age who is yet to achieve anything of note or worse still has a chequered past.
- It is very easy to make discreet inquiries and do internet and ASIC searches on the relevant individuals. Finally, how well do you understand the technology and the market the company operates in ?
- Do the research yourself while seeking out independent parties in the industry for a second opinion. Do not take anything at face value.

Never forget… cash flow in a start-up is everything and beware of the charismatic chairman who does not fully disclose these issues at board meetings.

SURVIVAL CHECKLIST FOR COMPANY DIRECTORS

1. Do 'Quick Analysis' at least every quarter, meaning the ratio of current assets divided by current liabilities in the company's balance sheet. A quick ratio of less than one is a cause for concern. Further, is the ratio improving or declining?
2. Periodically review related party loan accounts and fully understand the implications of these.
3. Ensure all compliance obligations with the ATO are up to date. This allows an overview of debt and avoids penalties and personal liability.
4. Leading on from this, always consider solvency issues – meaning can the company pay its debts as and when they fall due.
5. Consider the marketplace and the sometimes-rapid changes and challenges. Always question the ongoing viability of the business.
6. Often in SMEs, each director may have specific responsibilities - for instance, someone may be heavily involved in marketing. Such a person should insist on receiving key financial data monthly.
7. Be particularly careful with a start-up – essentially, the business model must be reviewed and tested by an experienced and competent accountant.

The above involves defensive steps that may be required, but we acknowledge where there are threats, there are also opportunities and that we like to see SMEs flourish and prosper.

ATO – DIRECTOR PENALTY NOTICES (DPN) – THE ATO IS ABOUT TO GET ACTIVE AGAIN

Moving into 2021/22, we are aware the Government stimulus package has largely ceased. We cannot pretend that things are back to normal. Only that we are learning to live with COVID-19. What can we expect?

- A DPN allows the ATO to seek unpaid company tax debt from a director personally in certain circumstances. There are two types of DPN's:
    1. Lockdown DPNs – A director is automatically personally liable for the company tax debt where the lodgements are outstanding for a period of 3 months (1 month for SGC) or more. The only way this can be resolved is with the DPN being paid in full.
    2. Non-Lockdown DPNs – Where the lodgements are up to date, but the ATO issues a DPN upon the directors, providing them with a period of 21 days to act. The options available include paying the debt or appointing a voluntary administrator or liquidator. If that action is taken within the prescribed period, personal liability is avoided.
- DPNs can be issued for unpaid GST (post-April 2020), PAYG, superannuation, luxury car tax and wine equalisation tax.

Make sure all lodgements are on time to avoid the lockdown DPN. That way, if the ATO issues a DPN, the director will have up to 21 days to avoid personal liability crystalising.

To date, the ATO has not been issuing DPNs in the COVID environment; this changed in the June 2021 quarter, whereby the ATO started taking action to collect unpaid tax debts and began the issuing of DPNs. It is pretty evident after the initial COVID-19 chaos that the ATO has resumed activity in this area.

DIRECTORS AND LEVELS OF PERSONAL RESPONSIBILITY

For those becoming a director for the first time, it is essential that the following is clearly understood. You can be held personally liable.

In the event of insolvent trading s588a:

- Not lodging BAS in a timely fashion, i.e., more than three months late, leaving the company owing GST, PAYG and superannuation in the event of liquidation.
- Giving personal guarantees.
- There being debit loan accounts in the company (you owe the company money) that a liquidator can pursue from an individual.
- There are other exposures, but the above are the most common.
- Anyone is capable of understanding these exposures, and the professional advisor should not just mention these at company inception but remind clients on a regular basis. The key message for any company director is ...you may be held personally responsible!

DO NOT GET FINANCIAL ADVICE FROM A LAWYER

Case study – Special Events Company

In this case, a successful 'special events' company in a regional city suffered a severe blow to their turnover. At the same time, their two most prominent clients, both large hotels, decided to take these functions in-house. Two-thirds of their turnover was gone.

Clearly, this was a time to slash overheads immediately, revise their business plan (if one existed) and seriously consider whether they should remain in business. Within a short length of time, a tax debt of 250k existed. With the ATO pressing, the owners went to their lawyers, who worked out a payment plan which involved 50% down and the balance over 12 months. Even with the sale of the family home, the couple struggled to achieve this. At the end of the 12 months, the ATO accepted a further $30k and then waited six months before liquidating the company avoiding any suggestion of preferential payments under the corporation's law. This couple lost everything.

It would be fair to ask...what should have happened?

As indicated above, closing down or a liquidation is a real option in the event of the business being unviable. It is illegal to continue to trade when insolvent. A reputable accountant could have advised on this matter.

Case study – Trading Company with Real Property becomes unprofitable.

In this case, an operating company with a $3 million commercial property on its balance sheet became unprofitable. There had been a lack of planning and asset protection structuring here. Fortunately, in this case, the business owners were advised that their business was no longer viable due to technological obsolescence and unlikely to return to profitability. The company was closed down in an orderly fashion, and the commercial property was retained. Again, this couple is in their sixties, but here they are, able to contemplate a comfortable and secure retirement.

Unwelcome Advice……

Undoubtedly the case when business owners are told to exit their industry. The accountant may be described as hopeless, negative, and lacking in understanding. Emotion can take over. But seriously… if a Doctor of Medicine tells someone they have an illness, are the same comments made? A second opinion may be sought in these cases, and there may be a referral to a specialist. All professional advisers have a duty of care to their clients. If a client is one quarter behind in their BAS payments for PAYG/Super and GST, a severe problem exists, and it needs to be addressed immediately. Realistic budgets need to be prepared for the business to establish ongoing viability. There may just be a seasonal lull in many cases, or there may be timing issues regarding trade debtors. In conjunction with the business budget, a family budget needs to be done. Is the overall position sustainable? It may well be the business is viable, but prompt remedial action needs to be taken regarding the family's living expenses. It could well be that excessive director's drawings eventually bring the business to its knees. Quite often, one owner shields their spouse from the actual situation. Sadly, in the absence of firm and objective advice, the problem just gets worse.

It really is the "Trusted Advisors" role to be honest and forthright with their clients. Accountants may lose fees, but it is imperative that they always act in the client's best interest.

THE OLD INCORRIGIBLES

These are the people who will not change their behaviour. Even after a successful turnaround or restructure that has saved their business or allowed them to remain in business, they simply continue as before.

What are the major offences? No business plan… chaos ensues. Excessive drawings by directors to pay for an unaffordable lifestyle, using the funds they hold on trust for the ATO, including GST and PAYG, are deducted from employees' wages.

Such people simply should not be in business…

As such phoenix companies are now under ATO focus; these people are now in real trouble.

THE CLIENT AND THE ADVISER

- The client is a Gentleman in his mid-fifties and has operated a successful business for seventeen years.
- Changes in the market have made his business marginal but still profitable.
- Under the weight of this pressure, our client battles fatigue and claims he is constantly putting out bush fires. No longer is he able to maintain an overview of his business.
- The business owes the wife's family $125,000.
- The adviser makes some suggestions he considers valuable, but the client dismisses them as impractical or too expensive.
- The client expresses concern about his business future, and the subject of asset protection is raised. Conventional asset protection techniques are suggested but again, the client baulks.
- The finance and stamp duty expenses, along with the capital gains tax consequences of safeguarding the family home seems too hard. The client laments, "in any case, the bank owns me."
- The client agrees to give the matters raised some thought…
- Nothing happens, but the adviser has made file notes concerning his advice which he may use to salve his conscience later.
- Two and a half years later, the business goes into liquidation, and the client is found personally liable for insolvent trading. When credit card debt is considered, there is the real prospect of losing the family home.

Nothing happened! It all seemed too hard at the time.

But this truly is the point…

- The client was impervious to change because he was barely coping.
- There were early warning signs.
- Asset protection is not too hard.

What should have happened?

Yes, there are real practical difficulties with restructuring, but at the very least, the following steps should have been implemented:

- Have only one "at-risk" individual, i.e., only one director.
- The wife's family could have taken a secured charge over the business.
- A new "operations" company that held no fixed assets should have been formed to operate the business under licence to isolate risk.
- Normal regular contributions to super should still have been made for the directors.
- The adviser should have given objective advice without fear or favour, telling the client that he should sell or close his business unless he were willing to implement changes to ensure his business survival.
- Brutal but honest advice was clearly in order.
- In the case of business closure, the client could then have earned a comfortable living as a consultant without all the pressure and without losing everything.
- It is often said that a business has a "life cycle." Often overlooked is the fact that individuals have a limited life in business.
- SWOT analysis (Strengths, Weaknesses, Opportunities, Threats) is usually done on a business, but this should often focus on the principal(s) in a family business.
- With the client exhausted and in denial, a fundamental break-even analysis is crucial. The client is clearly aware of the crucial turnover and gross profit figures required each month for business survival.
- Furthermore, the client should have been apprised of the insolvent trading provisions under the Corporation Law and the risk to family assets.
- Both the adviser and client should have monitored the figures on a monthly basis.

The Client

Lest you judge the client too harshly, consider the following:

- He is a hard worker who has been an excellent provider to his family and is well respected in his community. His children are well educated and have been given a perfect start in life.
- He has good technical skills and sound business ethics.
- However, exhaustion and fatigue have worn him out.
- In this case, the adviser has also clearly been found wanting.

It is the oldest profession in the world that lies back, fakes it and takes the money – Business advisers should note.

This outcome...

- It occurs (with variations) scores of times each week in Australia.

BEWARE OF THE WALK-AWAY ADVISER

We can expect many asset protection structures tested in the financial crisis post-Covid-19.

The trouble is some asset protection structures have been implemented without:

- The business owners having a clear understanding of the rationale behind the re-structure.
- A proper follow-up or overview by the adviser.
- A lack of ongoing review.

The main issues here are a lack of rigour and discipline around asset securitisation and inter-entity loan accounts.

THE ROLE OF THE ADVISER IN THE RECOVERY PERIOD

In short, the first point of contact for business owners must get more involved – this usually is the accountant. Examine debt with the ATO and state revenue authorities and get involved in negotiating terms. In the event of rent deferrals, negotiations with landlords are crucial.

You may need to ask some difficult questions.

Consider asking some of the following questions:

- Does a business need to retain more significant cash amounts for future challenges? We stress the importance of personal family budgets.
- Has the client's market changed, and do they now need to adapt to new circumstances to meet customer expectations?
- In short, is the business still viable?
- Do they need to restructure their employee numbers or retrain their employees to deal with the permanent changes that the business has seen occur in the last 12 months?
- How much has revenue grown or decreased?
- Are cost trends a concern, and what are the solutions/ alternatives?

COMPROMISED MENTAL HEALTH AND ASSET PROTECTION – COVID-19 STRESSES

In the second week of September each year, R U OK? Day aims to reach out to any of us with mental health issues ensuring mutual support and help.

It is hard enough for anyone to survive in business – at various points, many of us face stress, exhaustion, and mental health issues. Consider the myriad of legal and statutory obligations a SME has. These include but are not limited to:

- Income tax and GST
- Contractual obligations
- Duties of care
- Trade practices concerns
- Superannuation requirements
- Employment laws
- Obligations of fidelity and good faith
- Occupational health and safety requirements
- Privacy obligations
- Disclosure requirements
- State revenue obligations, including payroll tax and stamp duty.

It is essential that there are documented procedures and practices in each of these areas that overview the regulatory environment a business operates in. It also allows key support staff and family members to keep a company operating correctly in the event of the founder/ owner's illness.

The above statutory obligations are onerous at the best of times, let alone for someone suffering from illness.

Leading us on to the **lifeblood** of a business – it is cash flow.

- The accounting software company, Intuit, surveyed 500 accountants and bookkeepers, asking what their biggest problems were in their SMEs business. The top three responses were:
  - Lack of proper record-keeping, including the mixing of personal and business expenses.
  - The business not using accounting software.
  - Not understanding the importance of cash flow; not keeping track of bills and debts.

- Cash flow is key to any business. While cash pays the bills, many business owners cannot produce a cash-flow statement, which records incoming and outgoing cash amounts to assist them in managing the budget of those bills.

You can have the systems in place for all the above, but they need to be maintained, reviewed, and used as the basis for informed decision making, then timely action.

So, what is the takeout here?

Whether you be a consultant, adviser, friend, or family member, if you know a business owner struggling with life generally, then there is a distinct possibility that their business welfare is being neglected. Simply ask R U OK? You may be able to help them; this becomes even more important in the Covid-19 pandemic crisis.

Above all, business owners operating in these trying times need clarity – they need to clearly understand their options and be aware of the consequences of inaction. They do not need platitudes and throw away lines!

It is business advisors themselves who should take note of the following...

Is your client(s):

- Aware of director penalty notices?
- Aware of the perils of inter-entity and personal loan accounts?
- Aware of all personal guarantees and the consequences?
- Thinking clearly and showing a willingness to tackle the real issues?

And leading on to the advisor:

- Are you taking the time to deal with the issues?
- Do you genuinely care about your client(s) and their outcomes?
- Have you shown the fortitude to tell the client some unpleasant truths regarding their business?

You see, a client who gets prompt advice may have the opportunity to restructure.

A client who is allowed to continue going down a one-way track sometimes goes broke, sending good money after bad.

I have spoken to advisors who sheet all the blame home to the client and then complain their fees are unpaid! In some of these instances, it is the advisor who should accept some personal responsibility.

RESTRUCTURING BUSINESS

Of course, the time to start identifying risks is at the very beginning and certainly before we encounter financial difficulties.

Foremost, this is because the cost of having to implement a restructure for an established business may be substantial, and the restructure may be ineffective if the clawback provisions in the Bankruptcy Act or Corporations Act apply.

It is also vital to properly assess the actual risk. Most clients require external finance to fund their business assets and operations.

Never overlook that external financiers will generally require collateral securities and guarantees so that all assets connected with the business (and usually the director's private assets) are held as security.

In this context, the decisions concerning business structures may not impact the extent to which the clients' assets are exposed to claims by their financiers.

However, an appropriate structure can reduce the risk of the client's business and private assets from being exposed to claims of a contingent nature – for example, large damages claims arising from contractual disputes or negligence actions.

Fundamentally, avoid holding personal or passive investment assets in the same entity that carries on business activities. Doing so should not involve complex structures or significant costs – particularly if the asset protection issues are considered at the outset.

A married couple who operates a business with some risk potential might choose to:

- Acquire their home in the name of the wife or husband – but not jointly.
- Hold investment assets in a discretionary trust.
- Operate the business through a trading company and have a single director who is not the spouse who owns the family home.

Valuable business assets should also be separated from the risks associated with the trading operations.

It is increasingly common for intellectual property assets that contribute to the value of the business to be held in one entity and for that entity to grant a licence to the operating entity to use the intellectual property.

While using separate structures and splitting the ownership of assets does not completely quarantine clients' assets from the business risk, it will provide a reasonable level of protection.

Using separate business structures becomes very important for developers. A common strategy for developers is to establish a holding company in which shares are held by individual participants (usually a family trust) and then use a separate wholly-owned subsidiary company to carry out each project.

At the completion of each project, the project subsidiary is wound up, and surplus profits are distributed as dividends to the holding company.

Offshore Structures

On the leap of faith issue – if you go to a consultant specialising in these offshore issues, invariably recommendations will be to set up some offshore structures. Sometimes this occurs in cases where there is no good reason to do this. It just means expensive and unnecessary structuring.

Given quite often as the reason an offshore structure is necessary is Justice Robert French's decision in "ASIC in the matter of Richstar Enterprises Pty Ltd v Carey (No 6) (2206) FCA 814" and the possible far-reaching implications of that decision on the security and protection to assets held in a trust.

We discuss this case and the protective measures to overcome this elsewhere in this Bonus Edition.

There may be a place for offshore structures, but you should be genuinely conducting commerce overseas, and any management fees or charges must reflect commercial reality.

Far too often, "Professionals" line their pockets by providing unnecessary and costly structures.

In March 2014, the Commissioner of Taxation announced an initiative to allow eligible taxpayers to come forward and voluntarily disclose unreported foreign income and assets. He urged taxpayers with offshore assets to declare their interests ahead of a global crackdown on people using international tax havens.

The initiative covered amounts not reported or incorrectly reported in tax returns, including:

- Foreign income or a transaction with an offshore structure.
- Deductions relating to foreign income that have been claimed incorrectly.
- Capital gains in respect of foreign assets or Australian assets transferred offshore.
- Income from an offshore entity that is taxable in your hands.

These benefits were available only to eligible taxpayers who came forward before 19 December 2014.

Under the initiative, taxpayers had the opportunity to avoid steep penalties and the risk of criminal prosecution for tax avoidance.

We have seen a number of recent cases of "Whistle blowers" with explosive "Wiki Leak" style revelations. The last one being 11.5 million documents known as the "Panama Papers" leaked from leading offshore law firm Mossack Fonseca in April 2016.

This trend will continue along with information sharing between large numbers (90+) of the world's revenue authorities.

Those going offshore can no longer count on confidentiality.

CONTRACTORS, EMPLOYEES AND WORKCOVER

Recently a company went into liquidation. The company's major creditor was Workcover, and the debt arose because of an injury to a 'worker'.

The word worker is important because whether or not the person injured was actually a worker as defined in the Act and whether the company was an 'employer' at the time was the subject of some debate.

The company employed labourers under contract and did not consider them as 'employees' in the ordinary sense. But the employees were hired under a contract of service for the provision of labour only; therefore, they were 'workers' under Section 11, Schedule 2, Part 1, (1) of the QLD Workers Compensation and Rehabilitation Act 2003. Section 48 of the Act says that every employee must be insured.

Other Exposures

Other states have similar provisions in the relevant legislation. These include but are not limited to Payroll Tax and the Superannuation Guarantee Charge.

Here we see the consequences of one company choosing the path of least resistance. Indeed, this is an extreme example, but it is common for employers to encounter significant superannuation and payroll tax liabilities because they have not bothered to check their exposures for "subcontractors" under the relevant statutes.

From experience, Employers who want to get some or all their workforce on ABNs when these people are, in essence, employees have little prospect of long-term success.

- Commonly a business plan has not been prepared, and there are no long-term business strategies in place.
- Little attention is given to financial management.

- Having to budget for PAYG tax properly and other cash outflows forces a level of discipline in a business.
- Usually, Employers who "don't want the admin headaches" on relatively simple matters cannot be bothered with business strategies in what has become an increasingly challenging business environment.

The contractor versus employers' issue is an audit focus area for the ATO in 2021-22. From practical experience, these matters typically come to the attention of the ATO when they do a superannuation guarantee charge audit.

WHO IS GOING TO PROTECT YOU FROM YOURSELF (OR YOUR ADVISERS)?

When one mentions Asset Protection, it has some gravitas to require it denotes awareness and sophistication, which can be a problem.

We all want to feel important, and this coupled with self-important and fee-generating advisers can lead to problems being overstated with resultant, overly expensive and inappropriate structures. Over time some of these are not even adequately utilised or implemented.

A balance is required – you need to have a clear understanding of your situation and the reasons for the structures being implemented.

Beware the leap of faith when dealing with the suave, articulate adviser in the expensive suit. If you do not have a clear understanding or feel uncomfortable, seek a second opinion.

In recent years offshore "asset protection" has also been a cloak for tax evasion. Some of these inappropriate structures are causing real strife in the wake of the ATO initiated Operation Wickenby. If something sounds too good to be true, it generally is.

Similarly, since the Banking Royal Commission, it has become apparent to this tax practitioner that a number of clients did not understand the advice they received from some Financial Planners.

Once again, a leap of faith was involved with risky and inappropriate investments. Many people, particularly older persons, are never going to recover their position due to this. Many legitimate financial planners could justifiably take umbrage with these comments due to the meticulous care they exercise with their clients. Nonetheless, significant numbers of Australians have received inappropriate recommendations from accountants, consultants, and advisers.

What is the lesson here? Do not be afraid to ask questions. Always seek to gain an understanding. Advisers must earn your trust over time, and once again, if you have any doubts, always seek a second and, if necessary, a third opinion.

WHY ARE MORE PEOPLE INTERESTED IN ASSET PROTECTION?

The answer lies in the following developments...

- Society has become more litigious, meaning more people see legal action as a remedy or indeed opportunity.
- Over time we have seen an increase in the incidence of marital breakdown.
- Individuals have a greater consumer awareness of matters concerning investment and wealth accumulation.
- Failures of insurance companies have cast some doubt on the availability and extent of insurance cover.
- Amendments to bankruptcy laws threaten the effectiveness of existing arrangements and structures.
- The increasing complexity of our taxation system means minor deficiencies in structures can have significant tax impacts, threatening the effectiveness of existing arrangements and structures.
- The Covid-19 crisis has shattered business and consumer confidence leaving many in a marginal position.
- Many investors and business clients have made decisions based on the availability of cheap credit.
- The commencement on 30th January 2012 of the Personal Property Securities Act 2009 has significantly affected asset protection structures.

Broad Principles

Looking at a typical 'mum and dad family situation', the following fundamentals apply:

- There should be one 'at risk' person and one 'low risk' person.
- The 'at risk' person is involved in the operation of the business and should be the only director being exposed to liabilities associated with being a company officeholder.
- This 'at risk' person should not own or control any assets or wealth. Note sound Estate Planning means this person should not directly inherit wealth either.
- Control and ownership of all assets and wealth is the domain of the 'low risk' spouse. As such, they should not be exposed to any liabilities with directorships of

the trading companies. This must be distinguished from investment situations where the 'low risk' spouse may be the sole director or controller of an investment company or trustee of an investment trust with no trading operations.

The described outcomes are to:

- Contain risks in limited liability entities or as affecting 'at risk' entities only and
- To keep, accumulate or move assets away from 'at risk' entities and into the hands of 'low risk' entities (including superannuation funds).

In achieving these desired outcomes, you must not overlook the following:

- The moving of assets must take into account bankruptcy and other 'clawback' rules.
- Anticipate the future receipt of assets under wills and from superannuation with a view to keeping assets away from 'at risk' entities and individuals.
- **The continual changes in legislation and legal precedents. (See above)**

ASSET PROTECTION CHECKLIST

1. Property Transfers between Spouses - Consider Bankruptcy Act 'clawback' provisions that may defeat pre-bankruptcy transfers.
2. Are assets held in Company or Trust entities or Personal Names? - Business should conduct in an entity separate from where assets accumulate.
3. If an individual is a Company Director, are their assets owned personally? - Note personal liability of Company Directors.
4. Have any personal guarantees for business debts or liabilities been granted in favour of creditors? - Note: Seek releases when you leave the business.
5. Ensure discretionary trust provides for appropriate provisions in the event of bankruptcy of Appointor.
6. Ensure the loans from stakeholders to the business operating entity are appropriately secured with mortgage debenture, mortgage registered charge or other securities.
7. Where circumstances are appropriate, consider implementing asset protection strategies in relation to a spouse or de facto partner.
8. Consider implementing appropriate business structuring strategies for asset protection purposes:
   - Separate the ownership of intellectual property assets from business assets.
   - Use small business CGT provisions to move business away from property assets.
   - Consider more complex strategies that may be available.
9. Consider whether it is appropriate to transfer assets to a superannuation fund but take specialist advice.
10. Once problems arise, seek professional advice to implement an appropriate strategy to utilise in the circumstances.

TRUSTS, WHAT ARE THEY, AND HOW DO THEY WORK?

What is a Trust?

The general law still wallows to some extent in the feudal age, and society puts up with technicalities that can have no possible purpose except to confuse where trusts and the laws of trusts are concerned.

Trusts stem from the feudal system under which the Crown did not part with land ownership but instead allowed land to be used and occupied in return for feudal or knight service.

There must be a difference between the legal ownership of an asset and the beneficial ownership. There must be some person (either a natural person or corporation), that is, the actual owner of the property, and some other person (a natural person or corporation) that receives the benefit of the property referred to as the beneficial owner. The beneficial owner is the real owner of the property being the person who gets the "benefit of ownership". Where there is no separation between legal and beneficial ownership, then no trust can exist. Hence a Trustee cannot be the sole Trustee and at the same time the sole beneficiary of a trust.

There must be an asset in respect of which the trust exists, i.e., money, some object, a business etc. Without there being some object in respect of which the trust exists, there is nothing to be held in trust. Therefore, no trust. There must be certainty.

Both the Trustee and the beneficiary must know what is involved in the trust, how the Trustee's obligations are to be discharged, and the beneficial owner's entitlement. Hence, in the case of a discretionary trust, there is a settled sum that establishes the trust, a series of rules that enable the Trustee to discharge the duties of Trustee and determine (albeit by way of application of some formula) who the beneficiaries are or are to be. In a Unit Trust, defined units have a specific and defined value and similarly set rules that enable the Trustee to carry out the Trustees' obligations as Trustee.

Family (Discretionary) Trusts

The concern with Family Trusts continues, but what better vehicle currently exists to protect assets? Notwithstanding, the status of family trusts and hybrid trusts as an effective investment structure from both tax planning and asset protection perspectives has been under pressure.

In 1998, Treasury wanted trusts taxed as separate entities (the 'entity taxation regime') and prepared drafted legislation to implement the change. Due to pressure from the National Party and the business community, the government eventually rejected the entity taxation regime.

Since then, the effectiveness of the trust structure has been challenged by amendments to the bankruptcy legislation:

- Continuing attempts (to date unsuccessful) by trustees in bankruptcy to argue that the power of appointment over trust assets is of itself an asset of a bankrupt capable of being exercised by the trustee in bankruptcy.
- Amendments to bankruptcy legislation widen the situations in which trust assets might be exposed in the event of an individual associated with the trust becoming bankrupt.
- The Richstar decision calls into question the level of asset protection a discretionary trust can provide if one of the core people involved in the trust individually becomes bankrupt. The Richstar decision took on further significance when the judge who issued the decision, Justice French, subsequently became Chief Justice of the High Court.
- Various family law cases have continued to significantly undermine the trust structure where there is a personal relationship breakdown – perhaps the highest-profile of these cases was the High Court decision at the end of 2009 in Kennon v Spry.
- We also note The Bamford High Court decision and recent Decision Impact Statement released by the Tax Office relating to the issues associated with making effective trust distributions.
- The Government's decision to abolish the capital gains tax exemption for trust cloning in late 2008, which stripped the owners of many family trusts of the ability to restructure their trusts to achieve asset protection or succession planning objectives; and
- To capture and tax many arrangements where present unpaid entitlements had arisen following a distribution from a discretionary trust, numerous changes to the application of the Division 7A regime.

Discretionary Trusts

A Discretionary Trust is a legal entity where a Trustee holds assets legally in their own name on behalf of others (beneficiaries). The trustee manages the Trust Fund for the benefit of the beneficiaries, who are the recipients of the income and capital of the trust.

In a Discretionary Trust (also called a non-fixed trust), the Trustee has discretion as to which of the beneficiaries receives the Trust Fund's income or capital, and to what extent. The beneficiaries do not have a fixed entitlement or interest in the Trust Fund as they do in a unit or fixed trust. Discretionary Trust beneficiaries' rights are limited to; a right to be considered for nomination by the Trustee and to compel proper administration of the trust.

A Discretionary Trust is established by way of a Trust Deed entered into between the Settlor and the Trustee. The Trust Deed regulates the manner in which the Trustee can exercise its discretion. The Trust Deed is drafted by lawyers who practice extensively in this field. It provides the Trustee with a broad discretion regarding the classification of income and capital into different classes. It also contains a broad definition of beneficiaries to allow greater flexibility in tax planning and asset protection.

Benefits of a Discretionary Trust Deed

There are a variety of reasons why people establish Discretionary Trusts. The principal reasons being:

- Tax benefits which in turn lead to wealth creation
- Asset protection
- Providing financial security for family members during their lifetime
- Retaining control of the assets while having flexibility in how the income is distributed.
- Estate privacy

Unit Trust

A unit trust is a common investment vehicle that allows the pooling of investment funds and the investment of those funds through a trustee whose powers are clearly defined in a trust deed. The trustee may be assisted by a separate entity known as a manager, whose job is to select and manage the investments. In contrast, the trustee acts as a guardian of the interests of the unitholders.

Trust beneficiaries, known as unitholders, have set interests in the income and capital of the trust. These interests can often be on-sold by the unitholders.

Many unit trusts invite the subscription of public funds, which are then pooled and invested in specified items for income purposes or capital gain.

In certain circumstances, there may be advantages in selecting a trust as the form of business organisation, particularly from a taxation viewpoint. However, care must be taken to determine that it is appropriate for, amongst other things, the type of business, the taxation status desired, the required return, the degree of control required, and the flexibility needed.

A Superannuation Fund is a trust, in the same way as a family discretionary trust; however, it simply has a limited and special purpose. There are over 570,000 surging more towards 600,000 Self-Managed Superannuation Funds in Australia controlling $650B+ in assets. Given current incentives offered by the Government, they are increasingly popular as wealth accumulation vehicles with asset protection benefits.

What new developments are afoot for superannuation funds regarding asset protection?

Hybrid Trusts

The hybrid trust has the features of both a discretionary trust and a unit trust. The hybrid trust is based on the standard discretionary trust with the added feature that also offers a fixed (by unit) system of interest in the trust.

Hybrid trusts have become popular as vehicles for negatively gearing investment property with asset protection benefits. If a hybrid discretionary trust purchases a property, the taxpayer can gear the units, thereby claiming a tax deduction.

A negatively geared investment will not work in a family trust that has no other income to offset the loss. In trusts, and companies' losses are quarantined and carried forward to the following year.

The beneficiaries or shareholders cannot get the benefits of those losses to reduce their income. However, the hybrid discretionary trust can be administered as a normal discretionary trust for a couple of years until the investment funds are required. The trustee can then issue units. There is no need to issue units when the trust is set up. The flexibility is with the trustee, and generally, there are no stamp duties or capital gains tax implications.

Recent case law and Taxpayer Alert 2008/3 now makes it clear that the ATO will challenge the deductibility of interest on loans used to purchase units in some circumstances.

The ATO has expressed its concern about taxpayers claiming deductions for interest and other borrowing costs when the borrowing produces (or may produce) income for other people. This concern limits the use of hybrid trusts, and we urge caution. Notwithstanding, hybrid trusts still should be considered as an asset protection option.

LIFTING THE VEIL OF A DISCRETIONARY TRUST

Despite the duties imposed on trustees in bankruptcy, they are in many respects ill-equipped to penetrate the protective veil of a properly planned discretionary trust.

Genuine estate planning, which employs the discretionary trust well in advance of insolvency (rather than in response to it), remains an effective mechanism in protecting wealth.

An attempt to overturn a trust as a sham arrangement presents a trustee in bankruptcy with a tough challenge.

Where the trust arrangement cannot be challenged, the bankruptcy trustee is limited to a passive role, as in circumstances where there is a judicial sanction for the exclusion of creditor interests and the preservation of the bankrupt's power to control the affairs of the trust.

It is probably no surprise that only the Bankruptcy Act's remedies give the trustee clearly defined powers and rights of recovery. Even these powers are restricted.

The avoidance of transactions under Sections 120 and 121 is limited to arrangements made in the face of bankruptcy. Properly structured, long-standing trust arrangements are unlikely to be successfully challenged.

The remuneration skimming provisions of Division 4A of the Bankruptcy Act alone are capable of targeting the bankrupt's conduct regardless of the purpose for, or time at which, the trust was established. These provisions, however, are complex and unwieldy. They have been used successfully on only a handful of occasions.

Introduction

As a matter of policy, individuals are entitled to structure their financial affairs in any way that they see fit. However, the increasing sophistication of financial services makes it more difficult to distinguish between legitimate estate planning and the efforts of insolvents (or potential insolvents) to deprive creditors of their legitimate rights of recourse.

The common view is that the discretionary trust is the shelter of choice for the corporate cheat. More and more, this perception is colouring the reputation of the trust as an instrument of estate planning.

When the protective elements of the discretionary trust are called to action, it is often the trustee in bankruptcy who must weigh these competing considerations and decide when recovery action is warranted. The trustee in bankruptcy is charged with the collection, administration, and distribution of the assets of the bankrupt.

The term "discretionary trust" can conveniently be defined as a trust created by a settlor who settles property upon a trustee to hold on trust for identified potential beneficiaries.

The acquisition by a beneficiary of an interest in trust property, or the devolution of trust property for any purpose pursuant to the trust, depends on the exercise of the trustee's discretion.

The nature of a beneficiary's interest is that they only have a right to be considered as the potential recipient of benefit by the trustees and a right to have their interests protected by a court of equity.

Exposing Sham Trust Arrangements

Perhaps the most straightforward way for a trustee in bankruptcy to pursue trust property is to overturn the trust in its entirety. To this end, such a trustee may attempt to reveal the trust as a sham and pursue underlying property interests.

To be a sham, the creation of a trust must be a disguise for a different and independent arrangement to which all parties are in agreement (the parties being the trustee and the settlor).

Once the trustee in bankruptcy can establish a sham transaction, he must remove the disguise and identify the fundamental nature of the transaction.

The trustee in bankruptcy faces a formidable task when considering an attempt to identify a discretionary trust as a sham:

- At law, the trustee in bankruptcy must establish an intention, common to at least the trustee and settlor, to treat the discretionary trust as a mere disguise to an underlying arrangement or relationship. The trustee in bankruptcy is likely to allege a bare trust in favour of the settlor/debtor.
- Forensically, the trustee will require evidence beyond the exercise of mere influence or even control by the debtor. The trustee will have to breach the divide between control and beneficial ownership to establish entitlements to the underlying asset.

Trustee as Beneficiary

Suppose a beneficiary becomes bankrupt, and the trustee pays money or transfers property to the bankrupt after the fact. In that case, that money or property will automatically vest in the trustee in bankruptcy.

The trustee in bankruptcy occupies the position of "beneficiary" under the discretionary trust and may therefore exercise rights or powers have conferred by the trust instrument.

The beneficiary's interest in the trust is a mere discretionary interest. The right to be considered for a distribution falls well short of an entitlement to trust property or distributions. The trustee in bankruptcy, in right of the beneficiary, can sue if the trustee fails to exercise discretion.

Trustee's Discretion

The trustee's obligations are fiduciary. If the trustee has exercised discretion conscientiously and with integrity, it is unlikely that its decisions can be doubted.

The trustee may consider when exercising its discretions:

- Information is given to them personally or in a confidential memorandum, prepared by or on behalf of the settlor.
- The impact of taxation law on their decisions, where tax planning appears to be one objective of the trust).

Although not bound to follow the beneficiary's directions, the trustee must take into account the wishes of the beneficiaries.

The trustee's duties are to carry out the directions contained in the terms of the trust rather than directions later given by the settlor. A trustee is not a delegate of the creator of the trust or the beneficiary; neither can they direct the trustee in respect of carrying out duties unless the trust instrument (deed) empowers them to do so.

The exercise of discretion

A discretion given to trustees is not entirely unfettered. That would be inconsistent with the trustee's fiduciary duties to exercise an act of informed discretion and jeopardise the courts' supervisory jurisdiction.

Various cases have provided that trustees are to:

- Give effect to the settlor's intention in making a settlement...and will derive that intention not from the terms of the powers necessarily or exclusively, but from all the terms of the settlement, the surrounding circumstances, and their knowledge acquired or inherited...
- Inform themselves before deciding matters which are relevant to the decision. These matters may not be linked to simple matters of fact but will, on occasion, indeed, quite often, include taking advice from appropriate experts. It is, however, for advisors to advise and for trustees to decide....
- Consider the trusts prevailing circumstances when they exercised their powers, which may be different from those at the date of creating the trust.

Where a trustee exercises a discretion, it may be impugned on many different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously, or irrelevantly to any sensible expectation of the settlor, or without giving real or genuine consideration to the exercise of the discretion. The exercise of a discretion by trustees cannot, of course, be impugned upon the basis that their decision was unfair or unreasonable or unwise. Where a discretion is expressed to be absolute, it may be that bad faith needs to be shown. The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness.

Trust Powers

Discretionary trust instruments will often provide powers exercisable by the bankrupt. In some circumstances, that power will control the distribution of trust property. Exercise of the power in a manner favourable to the bankrupt could result in the acquisition of the property divisible among creditors.

Is a trust power exercisable by the trustee in bankruptcy, or is it fiduciary and therefore personal in nature?

The courts have considered that the powers conveyed by the trust ought to be used to benefit the beneficiaries of the trust rather than their creditors. Also, equity would not permit a trust power to use for an object which was extraneous to and in conflict with the objects of the trust.

The courts consider the power a trust or fiduciary power, being a power conferred by Deed of Trust, to be exercised accordingly in the interest of the beneficiaries. Thus, the power … is not "property" which vests in the trustee in bankruptcy, or a "power" as might have been exercised by the bankrupt for their own benefit".

Using Asset Protection Trusts

You can, in effect, create another exemption by placing your assets in a sophisticated form of trust. Properly formed asset protection trusts will make your property unavailable to creditors even when no other exemptions apply.

After reading these sections, take an inventory of the assets you own and how you own them. In doing this, you will gauge the degree of risk you face and make adjustments (conversions of assets) accordingly.

When dealing with asset transfers, timing is critical in asset exemption planning. Ideally, you will do this planning before your business is formed. Nevertheless, an owner of a thriving business also is an ideal candidate for effective exemption planning. Significant wealth can be protected before any serious problems develop.

The poorest candidate for exemption planning is the small business owner already in the midst of a financial crisis. Even here, however, steps can be taken, albeit cautiously, to protect assets.

Richstar

Richstar has raised a significant question regarding the protection offered by discretionary trusts. In the decision of ASIC v Carey (No 6) (2006) FCA 814 (**"Richstar"**), Justice French in the Federal Court was prepared to look through a trust and see the discretionary objects of the trust having an interest, justifying the appointment of receivers to the trusts.

COMMENTS ARISING FROM RICHSTAR

The message is clear for asset protection purposes. Only by removing control of the appointer, trustee and ensuring the trust is non-exhaustive can any discretionary trust be seen to avoid the risk of being the subject of a particular beneficiary's control.

Be warned. Insolvency practitioners will also look more closely at how discretionary trusts operate to see whether there is a degree of control over the trust equivalent to a proprietary interest. If this is the case, they may attack assets held in Trusts. For this reason, Richstar is a landmark decision.

In past editions, we have covered the Richstar case in detail. Still, developments in the law have not progressed in the way first contemplated by many first analysing the Richstar judgement. While it would be fair to suggest the same level of concern does not exist, there is no place for complacency.

Appointor of Trust Trumps Deregistration and Bankruptcy – Thorne Developments Pty Ltd (CAN 109 570 194) V Thorne (2015) 106 ACSR 481

We draw your attention to this case because it demonstrates how a suitably drafted Trust Deed may assist in protecting a Trust from deregistration of the Company Trustee due to the bankruptcy of its director. This is not an uncommon situation.

BLOODLINE TRUSTS

Having covered discretionary trusts, we mention in passing the key features of a bloodline trust.

- It is a full discretionary trust.
- The rules of the bloodline trust categorically provide that the capital (assets) of the trust can never go outside the bloodline during the life of the trust.
- Income may be allocated to in-laws, but the deed strictly stipulates that capital must stay within the bloodline.

These trusts are sometimes used in succession planning in the rural sector to ensure land and assets are passed on to the next generations.

However, we stress there can be a lack of flexibility, and there can be real issues (stamp duty and capital gains tax) if you want to add a beneficiary at a later date.

TRUSTS AND FAMILY LAW

In recent times there has been much talk about the "trust-busting" powers of the Family Law Court. This occurs when the court treats the trust property as the property of the parties or one of them making orders in the financial settlement that takes the trust property into account.

This takes the net asset (and the income derived from these assets) of the trust into account.

The key here is to take specialist advice when dealing with assets held in discretionary trusts with a view to protecting these assets from your own or your child's divorce or other co-habitation breakdowns. The clear objective here is to avoid the trust assets being treated as property of the parties and avoid the trust being treated as a financial resource if the outcome is that most non-trust assets are given to the other spouse, if not all.

The time for planning is at the start of the relationship – defensive moves such a removing a party's control when the relationship sours are likely to fail. Here, the court will be asked to consider the trust's actual history, including any changes when the marriage started to go wrong.

When entering a marriage or co-habitation, it would be helpful if a trust with assets in it was controlled by a party's parents. Having said this, if the party has the capacity to benefit, then the trust assets may still be treated as a financial resource.

The reality is that the Family Law Courts attack on trust assets will continue for the simple reason that it is contrary to public policy to allow matrimonial property to be shielded from a fair division.

Given this, binding financial agreements are becoming more popular – these can be made before, during and after marriage, dealing with property and financial resources, including superannuation entitlements.

It is stressed that you should seek specialist advice.

Key cases include:

- Milankov and Milankov (2002) 28 FamLR 514
- Coventry v Coventry & Smith (2004) FamCA 249
- Kennon v Spry (2008) HCA 56
- Simmons v Simmons (2008) FamCA 1088
- Woley and Humbolt (2008) FamCA 1094
- Essex & Essex (2009) FamCAFC 236
- Stephens and Stephens (2009) FamCAFC 240

Family Law Changes

We point these out because Trustees in Bankruptcy continue to struggle with the Family Law Court's relatively newfound jurisdiction in bankruptcy.

- In 2005, the Family Law Act (1975) (FLA) was amended to grant the Family Law Court power to make orders with respect to "the vested bankruptcy property concerning the bankrupt party to the marriage".
- This means the Family Law Court (FLC) is empowered to divest a trustee in bankruptcy of the vested bankruptcy property favouring the non-bankrupt spouse.
- The FLC considers sections 79 and the FLA – see Hickey v Hickey 2003 FLC 93-143.
- We would also draw your attention to Witt and Witt (2007), where there was a genuine separation of the parties.
- This opens some interesting possibilities if a "high risk" spouse is about to go bankrupt.
- If there are ill-winds blowing, get specialist advice as this could be very much to your advantage.

We refer you to the following cases Kennon and Spry (2008) HCA56

Other recent cases include:

- Edgehill & Edgehill (2007) FamCA 1102 at (82)
- Beeson & Spence (2007) FamCA 200 at (28)
- Stephens & Stephens (Enforcement) (2009)
- Leader & Martin-Leader (2009) FamCA 979 at (24)
- Pittman v Pittman (2010) FamCAFC 30 at (63)-(65)
- Harris & Harris (2011) FamCAFC 245
- Morton & Morton (2012) FamCA 30 at (35)

While the outcome of Kennon v Spry appears to undermine the fundamental principle of trust law, i.e., a mere discretionary beneficiary of a trust does not have a property interest in the assets of the trust. This decision was an example of the Court's utilisation of the broad powers provided to them under the Family Law Act in unique circumstances.

This is an evolving area of law and needs careful monitoring. The above decisions indicate that a well-structured trust will continue to be an effective vehicle for asset protection and estate planning.

SUPERANNUATION

A key feature of bankruptcy law that has acted as an appropriate safeguard to protect the interests of creditors was Sections 120 and 121 of the Bankruptcy Act 1966.

Sections 120 and 121 of the Act allowed a trustee in certain circumstances to recover property transferred prior to bankruptcy.

In the case of superannuation contributions, it was argued that for these transactions to be valid, the Superannuation Trustee should give valuable consideration to the contributions made by a debtor. If, as is the case in many superannuation deeds, the trustee's only obligation under the Deed is to recover additional contributions. Such obligations would probably not constitute valuable consideration under Section 120 and 121. However, in Cook v Benson (June 2003), the High Court disagreed with this proposition.

The amendments will:

a. Allow a trustee in bankruptcy to recover the value of contributions made by the bankrupt to defeat creditors, where the contributions were made to the bankrupt's superannuation plan and that of a third party.

b. Allow the trustee to recover contributions made by a person other than the bankrupt for the benefit of the bankrupt, where the bankrupt's primary purpose in participating in the arrangement was to defeat creditors.

c. Provide that consideration given by the trustee for the contribution be ignored when determining whether the contribution is recoverable by the trustee, thus, overcoming the effect of the High Court decision of Cook v Benson.

d. Allow the court to consider the bankrupt's historical contributions pattern and whether any contributions were 'out of character' in determining whether they were made intending to defeat creditors.

e. Provide that the superannuation fund will not have to repay any fees and charges associated with the contributions or any taxes it has paid in relation to the contributions; and

f. Give the official receiver the power to issue a notice to the superannuation fund or funds holding the contributions that will freeze the funds preventing the bankrupt from rolling them over into another fund or otherwise dealing with them in circumstances where the trustee is entitled to recover them.

These changes will not be retrospective and apply to any 'out of character' contributions made after 27 July 2006.

If approaching bankruptcy, note that it is crucial to keep the funds in Superannuation. Superannuation remains an effective asset protection technique as long as you can prove that you were solvent when the payments were made.

Self-Managed Super Funds and Bankruptcy

A corporate trustee manages most SMSFs, and the SIS Act requires all members of the SMSF to be a director of that corporate trustee. But a difficulty arises when a member becomes bankrupt as the Corporations Act prohibits a bankrupt from acting as a director of any company. Further, under the superannuation legislation, a bankrupt is a "disqualified person" and cannot participate in the management of a super fund.

Clearly, if a bankrupt cannot be a director of the trustee of a SMSF, he cannot be a member of that fund, and his entitlements will need to be dealt with otherwise. But the good news is that there is a six-month period of grace during which this issue can be addressed.

The period of grace applies only to dealing with the bankrupt's entitlement. There is no period of grace in relation to acting as a director, meaning that if the bankrupt is the sole member of the SMSF and the sole director of the trustee company, he will need to arrange for a new director to be appointed quickly.

The easiest way to deal with a bankrupt's interest in a SMSF is to have that interest transferred to a larger fund within the six-month period of grace; this is not a transaction that the trustee in bankruptcy can frustrate unless they believe that that interest includes contributions that should not have been made and recoverable under section 128B of the Bankruptcy Act.

Another option is for the members' entitlements to be paid out, assuming that this is permissible under the relevant deed and legislation. A superannuation payout made after bankruptcy is exempt from realisation in the bankruptcy. If the entitlement is taken as a pension, it will be included as income of the bankrupt when the trustee assesses whether or not income contributions are payable. Again, the provisions of section 128B may apply in some circumstances.

Are Superannuation Monies within the Taxman's Reach?

As we can see above, as long as contributions are made into superannuation when the contributor is solvent and not with an intention to defeat creditors, superannuation funds do have asset protection benefits.

Recently Denlay v Commissioner of Taxation (2013) FCA 307 saw a long-speculated question put to the test.

The ATO holds many powers to recoup what is owed to them, including the power to 'garnishee' the tax debtor's bank accounts, some trust funds, property sale proceeds, company shares and trade debtors. An unresolved issue was whether superannuation funds were also part of the list.

A garnishee notice is a process where an entity receives a notice demanding monies held on behalf of a tax debtor, which is expressly taken as being authorised by the debtor and any other persons also entitled to all or part of the funds. This third party is compelled to make the payment directly to the ATO and indemnified for doing so.

Superannuation funds, by nature, are supposed to be a protected source of money. So, it has been said that a garnishee order would not be effective until the tax debtor's (member's) benefits are payable under the rules of the fund – which is usually when the member retires or dies. In the event of bankruptcy, superannuation monies are excluded from the definition of divisible property and, therefore, cannot be realised by a bankruptcy trustee for the benefit of creditors.

In Denlay v Commissioner of Taxation, a garnishee was issued over the taxpayers' superannuation fund. At this time, the parties were partway through the hearing of appeals filed by the Denlays to amended income tax assessments made by the ATO. At a time when the ATO had consented to an order for a stay of the enforcement of a judgment in relation to the tax debt.

Mr and Mrs Denlay were declared bankrupt in 2012 upon lodging the debtor's petitions, and Mr Denlay was not in a position to pay the tax debt or further fund the appeal of the assessment.

Early in 2013, the Denlays filed an application in the Federal Court seeking a judicial review of the Commissioner's decision to issue the garnishee notice, particularly given the stay on the enforcement of the judgment. The court accepted the Denlays argument and quashed the garnishee notice, ordering that the monies be refunded to the superannuation fund, awarding costs in favour of the Denlays on an indemnity basis.

However, this garnishee was quashed because it was considered inappropriate to issue such a notice at the time of a court-ordered stay on enforcement proceedings, not because superannuation monies are generally believed to have some sort of protection.

We also refer you to the below case:

Australasian Annuities Pty Ltd (In Liquidation) V Rowley Super Fund Pty Ltd (2013) VSC 543 (Supreme Court of Victoria, Almond J, 17 October 2013)

RECENT DEVELOPMENTS

So, it is clear the Commissioner has the power to issue a garnishee notice meaning the amount of money sitting in the super account can be swept up in the garnishee notice and taken immediately. The ATO has special powers to self-issue the garnishee notice. A creditor can also seek to obtain superannuation money with a Court ordered garnishee.

Debt can be claimed under a garnishee notice requiring anyone who holds money for the debtor/taxpayer to pay the money to the creditor/ATO.

The garnishee will not be effective until the debtor's (member's) benefits are payable under the rules of the (superannuation) fund. At that point, the super fund will be required to pay the garnisheed amount to the Commissioner or relevant creditor.

The key concept is what is "due and payable" from the superannuation fund. The person claiming the garnishee (including the ATO) can only garnishee what is accessible by the superannuation member. And this will depend on the rules of the fund. It is the "rules of the fund" concept that is the key to a potential solution.

People need to get clear advice, be aware of their exposures and promptly act if bankruptcy is inevitable before a garnishee can be issued. Once a garnishee issues (whether ATO or creditor), it may be very difficult to protect the super. Declaring bankruptcy after the fact is too late; once issued on the super, it will already have been garnisheed. **Assess the probability and, if inevitable, protect the super by embracing bankruptcy. All the protections of the Bankruptcy Act will then apply.**

But what about the pre-bankruptcy phase? The key to enhancing super's pre-bankruptcy protection lies in the phrase "due and payable". It is only an amount that is "due and payable" from the super fund to the member that may be subject to a garnishee notice.

Of course, superannuation still the subject of a condition of release is not due and payable. The minimum standards of the Superannuation Industry (Supervision) Act and Regulations recognise no superannuation is due and payable until a condition of release is satisfied. Progressively the most common such condition is terminating an employment after the age of 60 or reaching the age of 65.

If the superannuation is not due and payable before terminating an employment after the age of 60 or before reaching the age of 65, the garnishee notice will not be effective. Otherwise, it can be and will.

Clearly, it is Australians over the age of 60 who have the exposure here. In the event of financial hardship, this complex issue takes specialist advice to protect your super.

THE CLAWBACK PROVISIONS

A lack of planning may prove fatal due mainly to the clawback provisions of the Bankruptcy Act, rendering manoeuvres to defeat creditors ineffective.

Section 120: Undervalued transactions

(1) A transfer of property by a person who later becomes a bankrupt (the transferor) to another person (the transferee) is void against the trustee in the transferor's bankruptcy if:

(a) the transfer took place in the period beginning five years before the commencement of the bankruptcy and ending on the date of the bankruptcy; and

(b) the transferee gave no consideration for the transfer or gave consideration of less value than the property's market value.

(2) Subsection (1) does not apply to:

(a) payment of tax payable under a law of the Commonwealth or a State or Territory; or

(b) a transfer to meet all or part of a liability under a maintenance agreement or a maintenance order; or

(c) a transfer of property under a debt agreement; or

(d) a transfer of property if the transfer is of a kind described in the regulations.

(3) Despite subsection (1), a transfer is not void against the trustee if:

(a) in the case of a transfer to a related entity of the transferor:

(i) the transfer took place more than four years before the commencement of the bankruptcy; and

(ii) the transferee proves that, at the time of the transfer, the transferor was solvent; or

(b) in any other case:

(i) the transfer took place more than two years before the commencement of the bankruptcy; and

(ii) the transferee proves that, at the time of the transfer, the transferor was solvent.

Section 121: Transfers to defeat creditors.

(1) A transfer of property that later becomes a bankrupt (the transferor) to another person (the transferee) is void against the trustee in the transferor's bankruptcy if:

(a) the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred; and

(b) the transferor's main purpose in making the transfer was:

(i) to prevent the transferred property from becoming divisible among the transferor's creditors; or

(ii) to hinder or delay the process of making the property available for division among the transferor's creditors.

(2) The transferor's main purpose in making the transfer is taken to be the purpose described in paragraph (1)(b) if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent.

(3) Despite subsection (1), a transfer of property is not void against the trustee if:

(c) the consideration that the transferee gave for the transfer was at least as valuable as the market value of the property; and

(d) the transferee did not know or could not reasonably have inferred that the transferor's main purpose in making the transfer was the purpose described in paragraph (1)(b); and

(e) the transferee could not reasonably have inferred that, at the time of the transfer, the transferor was or was about to become insolvent.

Section 123(6) provides that:

"Subject to section 121 nothing in this Act invalidates, in any case where a debtor becomes bankrupt, a conveyance, transfer, charge, disposition, assignment, payment or obligation executed, made or incurred by the debtor, before the day on which the debtor became bankrupt, under or in pursuance of a maintenance agreement or maintenance order."

WHICH ASSETS CAN BE TAKEN OR SOLD IN BANKRUPTCY?

Divisible and non-divisible property

Asset protection extends into bankruptcy, and you need to understand the tricks, traps, and pitfalls fully. All too often, bankrupts lose family assets due to a lack of understanding or oversight or a lack of care.

It is necessary to understand which assets in a bankruptcy a trustee can realise. The Bankruptcy Act 1966 defines assets into two categories:

1. Divisible assets available to a trustee.

2. Non-divisible-assets not available to a trustee.

This issue is frequently disputed.

Section 58 of the Bankruptcy Act merely states all divisible property vests in the bankruptcy trustee. The starting point for the bankruptcy trustee is that divisible property is all the property of the bankrupt. Non-divisible assets are then eliminated from the list.

The Bankruptcy Act broadly defines divisible property as covering the following:

- All property owned at the time of bankruptcy or acquired during the bankruptcy.
- Any rights or powers over property that existed at the date of bankruptcy or during the bankruptcy.
- Any rights to exercise powers over property.
- Any property that vests because an associated entity received the property resulting from personal services supplied by the bankrupt (section 139D of the Bankruptcy Act).
- Monies recovered from an associated entity due to an increase in the entity's net worth resulting from personal services supplied by the bankrupt (section 139E of the Bankruptcy Act).

Section 116 of the Bankruptcy Act lists what classes of assets are also divisible among creditors.

BANKRUPTCY ACT 1966 – SECTION 116

Property divisible among creditors

Subject to this Act:

a. all property that belonged to or vested in by a bankrupt at the commencement of the bankruptcy; or has been acquired or is acquired by them, or has devolved or devolves on them after the commencement of the bankruptcy before their discharge; and

b. the capacity to exercise, and to take proceedings for exercising all such powers in, over or in respect of property as might have been exercised by the bankrupt for their own benefit at the commencement of the bankruptcy or at any time after the commencement of the bankruptcy and before their Discharge; and

c. property that is vested in the trustee of the bankrupt's estate by or under an order under section 139D or 139DA; and

d. money that is paid to the trustee of the bankrupt's estate under an order under section 139E or 139EA; and

e. money that is paid to the trustee of the bankrupt's estate under an order under paragraph 128K(1) (b); and

f. money that is paid to the trustee of the bankrupt's estate under a section 139ZQ notice that relates to a transaction that is void against the trustee under section 128C; and

g. money that is paid to the trustee of the bankrupt's estate under an order under section 139ZU; is property divisible amongst the creditors of the bankrupt.

What is non-divisible property?

Determining what is not divisible property can be a problematic area.

The Bankruptcy Act provides that some property types will not be divisible among creditors under Section 116(2).

The list of non-divisible assets is extensive, but in most cases, these assets rarely appear. Some are pretty common and are non-divisible because they are necessary for the bankrupt's ability to maintain a standard of living.

These can be grouped into the following areas:

- Property held by the bankrupt in trust for another person (i.e., not owned by the bankrupt).
- The bankrupt's household property.
- Personal property that has sentimental value for the bankrupt and is identified by a special resolution passed by the creditors before the trustee realises the property.
- The tools of the trade that the bankrupt uses to earn income by personal exertion are subject to the value threshold.
- A vehicle used by the bankrupt as a means of transport, subject to the value threshold.
- Policies of life assurance or endowment assurance covering the life of the bankrupt or their spouse, whether the proceeds are received on or after the date of the bankruptcy.
- The bankrupt's interest in a regulated superannuation fund.
- Payment to the bankrupt under a payment split, under Part VIIIB of the Family Law Act 1975, where the eligible superannuation plan is a fund or scheme covered by the Act, and the payment is not a pension within the meaning of the Superannuation Industry (Supervision) Act 1993.
- Money held in the bankrupt's retirement savings account (RSA)-or a payment to a bankrupt from an RSA

received on or after the date of the bankruptcy—if the payment is not a pension or annuity within the meaning of the Retirement Savings Accounts Act 1997.

- Payment to the bankrupt under a payment split under Part VIIIB of the Family Law Act where the eligible superannuation plan involved is an RSA, and the payment involved is not a pension or annuity within the meaning of the Retirement Savings Accounts Act.
- Any right to recover damages or compensation (or amounts received before or after bankruptcy) for personal injury or wrongdoing or regarding the death of the bankrupt's spouse, de facto partner, or family member.
- Amounts paid to the bankrupt under a rural support scheme as prescribed by the Act.
- Amounts paid to the bankrupt by the Commonwealth as compensation in relation to loss as prescribed by the Act relating to the rural support scheme.
- Property that was purchased or acquired with protected money.
- Any property that, under an order—under either Part VIII or Part VIIIAB of the Family Law Act 1975—the trustee is required to transfer to the bankrupt's spouse or a former spouse or former de facto partner.
- The bankrupt's property that is a support for the bankrupt that was funded under the National Disability Insurance Scheme (NDIS), or NDIS amount as defined in that Act.
- Some divisible property, including cars and tools of the trade (see above), act subject to statutory value thresholds, indexed by the Australian Financial Security Authority (AFSA).

The thresholds are designed to allow bankrupts to maintain a standard of living (the household property limitations) and maintain some employment (the tools of the trade and motor vehicle limitations).

Time limits for realisation

Section 129AA of the Bankruptcy Act sets the periods that apply to divisible assets for the bankruptcy trustee to deal with these assets. Any divisible assets a bankrupt discloses must be realised within six years after the bankrupt is discharged. A bankruptcy trustee can extend this period up to three years at a time by giving written notice to the bankrupt before the six-year expiry. There is no limit on how many extensions a bankruptcy trustee can seek.

For after-acquired property disclosed during bankruptcy, the bankruptcy trustee has six years after the bankrupt's discharge date to deal with the property. For any after-acquired property a bankrupt discloses after discharge, the bankruptcy trustee has six years from the disclosure date to realise the property. Again, a bankruptcy trustee can extend these periods.

If these assets are not dealt with during the required period, they can revert to the bankrupt.

Section 127 of the Bankruptcy Act outlines that a trustee has 20 years from the date of bankruptcy to deal with a bankrupt's property. After the 20 years' expiry, the property reverts to the bankrupt.

UNDISCHARGED BANKRUPTS AND INCOME TAX REFUNDS

Many people enter bankruptcy with large tax debts owed to the ATO. A general question is what will happen to the debtor's tax refunds after bankruptcy.

During bankruptcy, the debtor has to lodge their income tax returns each year as usual. Usually, any ongoing personal income tax refunds are retained by the ATO and set off against the ATO's pre-bankruptcy debt until the debtor is **discharged** from bankruptcy.

After being discharged from bankruptcy, the debtor will resume receiving their personal tax refunds if applicable.

Upon release from bankruptcy, the individual is released from all debts that were provable in the bankruptcy (i.e., during the pre-bankruptcy period). Prior to discharge, tax debts remain owing, and the ATO has the power to retain tax refunds and apply them against the debt it is owed. Refer to Taylor v DCT [1987]

Upon discharge from bankruptcy (usually three years from lodgement of the debtor's Statement of Affairs, unless there is an objection to discharge), the pre-bankruptcy debt is considered to be irrecoverable at law, and the ATO 'writes off' these debts.

There is an exception where a tax refund relates to a pre-bankruptcy period; the ATO will retain the refund and set it off against the pre-bankruptcy debt, even after discharge.

AN INSOLVENCY SAFE HARBOUR FOR COMPANY DIRECTORS

In September 2017, new legislation was passed providing "safe harbour" protection for company directors against insolvent trading claims while developing and implementing plans to restructure the company.

Background

The *Corporations Act 2001 (Cth)* prohibits company directors from engaging in insolvent trading.

A director can be liable for debts incurred by the company while it is insolvent or if incurring the debt makes the company insolvent. The action is brought against the director by the liquidator when a company enters liquidation.

This new "safe harbour" legislation allows directors to attempt a restructure of the company without the threat of personal liability for insolvent trading and encourages directors, when they believe that the company is insolvent, to take action that is reasonably likely to lead to a better outcome than formal insolvency.

Many consider the insolvent trading laws have led to companies being placed into voluntary administration or liquidation to avoid personal liability in circumstances where the company may have been viable in the longer term.

The new laws aim to give directors space to consider other strategies and to take reasonable risks without the threat of personal liability.

A director will enter safe harbour if they:

- suspect the company could be insolvent.
- starts developing, and within a reasonable time puts into effect a course of action that is reasonably likely to lead to a better outcome for the company.

It is crucial to develop a course of action. Optimism is not a course of action.

Safe Harbour is not allowed if the company has not:

- paid its employee entitlements, including superannuation, by the time they fell due.
- provided its returns, notices, statements, applications, or other documents to the ATO more than once during the 12-month period prior to a debt being incurred from which the director seeks the protection of the safe harbour.

Record keeping

When faced with an insolvent trading claim by a liquidator, directors must demonstrate they have met the legislative requirements for entry into the safe harbour. That means showing:

- employee entitlements were paid when due.
- tax reporting obligations have been met.
- a developed course of action, framed reasonably likely to lead to a better outcome for the company.

These must be documentation showing:

- the company's financial position at the time the insolvency was suspected.
- the likely outcome if the company was placed into formal insolvency (to show that the course of action undertaken was reasonably likely to result in a better outcome).
- advice on the restructure was from qualified advisors such as an accountant or lawyer and their opinion about the prospects of the restructure achieving a better outcome, and
- strategies implemented to measure the turnaround (including the creation of turnaround committees and alternative plans).

Those who have not kept proper records or are seeking not to pay employee entitlements or not pay money they are holding in trust for the ATO (PAYG and GST) cannot enter the safe harbour. Quite properly those seeking safe harbour need to be up to date in their lodgements with the ATO.

Safe harbour is there for those company directors who have dealt with adverse trading conditions but genuinely tried to do the right thing. Documentation is the key, and you must seek expert advice.

Ipso Facto Clauses

The new law puts a 'stay' on ipso facto clauses in contracts by preventing the enforcement of those clauses in certain circumstances, including when a company enters into administration or where the company is undertaking steps to avoid being wound up in insolvency. The period of the stay varies depending on the circumstances. For a company in administration, the period of the stay commences when a company comes under administration and ends when the administration ends.

By making ipso facto clauses unenforceable during a company's restructure, financially distressed companies will have some 'breathing space' to continue to operate while they restructure and take steps to avoid becoming insolvent.

The stay on enforcement of the ipso facto clauses came into force on 1.7.2018 and only applies to contracts entered into after 1.7. 2018.

COVID-19 INSOLVENT TRADING PROVISIONS – KEY ISSUES

Directors must be conscious of how their company incurs debts in the COVID-19 environment. While the government has given a reprieve on insolvent trading until 25 September 2020, it is not entirely clear which debts are protected under the insolvent trading provisions, and directors' personal liability for any claim made post-COVID-19.

Section 588GAAA of the Corporations Act was introduced on 23 March 2020 with the passing of the Coronavirus Economic Response Package Omnibus Bill 2020 by the Federal Parliament. The section says that a director will not be personally liable for insolvent trading in respect of company debt if incurred:

- in the ordinary course of the company's business
- during the six-month period from 25 March 2020 to 25 September 2020, or any more extended period the regulations prescribe.

In the COVID-19 business environment, the question is, what constitutes "the ordinary course of the company's business".

Never lose sight of the spirit of the legislation, which is to provide temporary relief and support business survival if possible and appropriate. As a guide, the government has outlined:

"A director is taken to incur a debt in the ordinary course of business if it is necessary to facilitate the continuation of the business during the six-month period".

All the preceding comments regarding safe harbour are relevant here. Always consider this as it is not clear where the line of demarcation will be post-Covid-19.

ONE-YEAR BANKRUPTCY A STEP CLOSER

The Bankruptcy Amendment (Enterprise Incentives) Bill 2017 ("the Bill") was referred by the Senate on 30 November 2017 to the Legal and Constitutional Affairs Legislation Committee for inquiry and report. The Committee was due to report by 19.3.2018. After submissions closed on 31.1. 2018.

The March deadline was not met, and the time of going to print there had no further developments.

The Bill reduces the period a bankrupt individual must wait for an automatic discharge from bankruptcy from 3 years to 1 year after filing a statement of affairs by the bankrupt.

However, bankruptcy remains subject to the income contribution regime until the later three years from the day they became bankrupt or discharged.

This amendment may result in higher income contributions being paid to the bankrupt estate by a discharged bankrupt than may have been paid if the period of bankruptcy remained three years. The reasoning here is that after the 1-year period of bankruptcy, a discharged may return to business activities or gainful employment without the social stigma and legal disabilities of bankruptcy.

On the other hand, what incentives will the former bankrupt have to comply with their continuing obligations without the possibility of the Trustee objecting to a bankrupt's discharge?

If the legislation is passed, this would not be the first time Australia's bankruptcy discharge period has fallen to one year; the Bankruptcy Act 1966 previously allowed an "early discharge" after 12 months at the bankruptcy trustee's discretion. However, the law reverted to a three-year period in 2003 because it was believed the shorter period discouraged debtors from trying to enter debt arrangements with their creditors.

The intention was that this legislation was passed late in 2018 and receive royal assent early in 2019. At the time of going to publication, this had not occurred, and there remains some doubt as to whether this legislation will now be passed.

The Senate Legal and Constitutional Affairs Legislation Committee recommended that the Corporations Act be amended to ensure that the one-year default period does not allow bankrupts discharged after that period to immediately become the sole director of a propriety company. Subject to that recommendation, the Committee recommended that the Bill be passed. We will keep you informed on developments.

STRENGTHENING COMPANY AND DIRECTORS' OBLIGATIONS

Director's Penalty Notices –Legislation

The Government passed this legislation in July 2012.

- In addition to liability for PAYG withholding amounts, directors are personally liable for their company's unpaid superannuation guarantee charge. Further legislation, effective from 1.4.2020, extends this to GST.
- A new director is not liable to a director penalty for company debts that existed when they became a director until 30 days after they became a director.
- In addition to estimating unpaid PAYG withholding liabilities, the Commissioner can estimate unpaid superannuation guarantee charges.
- The Commissioner may also serve a copy of a director penalty notice on the director at their tax agent's address.
- Where three months have lapsed after the due day, the director penalty is not remitted by placing the company into administration or beginning to wind it up.
- New directors are not subject to these restricted remission options until three months after becoming a company director, rather than three months after a debt arose.

- In addition to these defences, a director that becomes liable to a director penalty for not causing its company to comply with its superannuation obligations is not liable to a director penalty if:
  - the company treated the SGA Act 1992 as applying to a matter in a way that was reasonably arguable and,
  - where the company took reasonable care in applying the SGA Act 1992 to the matter.
- Where a company has failed to pay PAYG withholding amounts to the Commissioner, the Commissioner has a discretion to reduce a director's entitlement to PAYG withholding credits relating to withholding payments made by the Company.
- Company directors and their associates entitled to a credit attributable to a payment by a company that has failed to pay amounts withheld under PAYG withholding to the Commissioner can be liable to pay PAYG withholding non-compliance tax.

Tips for Company Directors

If you are about to accept a position as a company director:

- As part of your due diligence, ensure that you cover the company's GST, PAYG, and superannuation guarantee obligations. A new director will become liable to a director penalty if, after 30 days of joining the company, the company still has not discharged its obligations.
- Companies should review their GST, PAYG and superannuation compliance procedures to ensure there are no risks identified, such as incorrectly classifying employees as contractors or incorrectly calculating their superannuation obligations.

ILLEGAL PHOENIXING

The Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 passed through Parliament and received royal assent on 17 February 2020.

The latest laws come under a suite of legislative initiatives introduced to Parliament to combat this illegal activity, which is estimated to cost taxpayers billions of dollars annually.

The reforms are significant, including:

- restricting director resignations from being backdated.
- preventing directors from resigning if it leaves the company without a director.
- extending the director penalty regime (DPN) to cover a company's GST liabilities in certain circumstances.
- prohibiting "creditor-defeating dispositions" of company property.

ADDITIONAL EXPOSURES FOR DIRECTORS, TWO CASES – CREDITORS AND FINANCIERS

Do not think you can hide behind corporate veil...

Personal liability for misleading contractual promises

It should be noted Australian Consumer Law (ACL) can render directors personally liable for misleading or deceptive conduct engaged in on behalf of a company in commercial transactions.

A contractual promise will imply representations about the present intent and ability of the company to perform the promise. It is critical that reasonable grounds can be demonstrated for making these representations because the potential personal exposure of the director who transacted the deal can otherwise be devastating.

We direct you to the Western Australian Supreme Court decision in Grande Enterprises Ltd v Pramoko (2014) WASC 294, 22.08.2014. Here the director in question was effectively ordered to personally acquire an asset sold by him on behalf of the company for $2,250,000.

Unreasonable Director Related Transactions (UDRTs)

Liquidators have several weapons at their disposal for recovering money or assets that have been removed from a company before it goes into external administration.

One powerful addition to the liquidator's arsenal is the Unreasonable Director Related Transaction (UDRT).

Following the collapse in 2001 of HIA due to large director bonuses, the Federal Parliament in 2003 passed the Corporations Amendment (Repayment of Director's Bonuses) Act 2003, explicitly aimed at providing a way to recover bonuses paid to the directors of failed companies. Since then, the new powers have had a much wider practical implementation.

The 2003 Act introduced section 588FDA to the Corporations Act. The new section applies to transactions between a company and a director of the company or a "close associate" of the director and transactions involving the company and third parties acting on behalf of a director or close associate.

Liquidators can establish that a transaction is a UDRT if it can show that a reasonable person in the company's position would not have entered into it after consideration of the benefits and detriments to the company, the benefits gained by others, and "any other relevant factor." Once unreasonableness is established, the liquidator has a range of options under section 588FF to recover the money or property transferred or otherwise relieve the company of the burden of the UDRT.

- **We can expect to hear more of URDT given recent corporate collapses. All this points to is the need for detailed asset protection prior to getting into financial difficulties.**

A decision of the Victorian Court of Appeal, in Vasudevan v Becon Constructions (Australia) Pty Ltd (2014) VSCA 14, has the potential to significantly broaden the power of a liquidator to attack a company transaction under section 588FDA of the Corporations Act 2001 (Act), where there are 'indirect benefits' to a director or close associate of a director of the company.

Although liquidators welcomed the decision, it has worrying implications for financiers or creditors. Even a third-party arm's-length creditor could be caught.

For creditors, the type of transaction most at risk will be where a company has provided a guarantee or security for a third party's debt.

Suppose a transaction is an unreasonable director-related transaction. In that case, there is a four-year relation back period. The liquidator does not have to prove insolvency at the time of the transaction or that the company became insolvent as a result of the transaction.

No doubt an advantage to the liquidator but very worrying for financiers and creditors.

Some relevant recent case law includes:

- Weave v Harburn (2014) WASCA 227
- Lyngray Developments Pty Ltd (In Liquidation) v Dushas & Anor (2013) QCA55
- Great Wall Resources Pty Ltd (in liq) (2013) NSWSC 354
- I & K Frost Pty Ltd (in liq) v Frost (2014) NSWDC 193

FRAUD DANGERS FOR MATURE BUSINESS OWNERS

For mature business owners, read "older", and this very much is a generational issue.

In the last 30 years, there has been a significant shift as most small businesses have moved to computerise their records completely.

For business owners (typically those in middle age or older), who do not know their way about the ledgers, say, Xero or MYOB, this could be dangerous.

Formerly such business owners would carefully scrutinise their manual cashbooks on a monthly basis.

If your business is profitable and it is known you are "hands-off", this could be a problem. You should have the basic skills to navigate your accounting system. If not, get tuition and bear in mind you do not need accounting expertise to identify false transactions as you will generally know what is and isn't going on in your business.

If you cannot do this, at the very least, request hard copies of monthly ledgers, scrutinise these and ask questions to put your staff on notice that you are checking things.

Finally, you cannot count on your Public Accountants to always pick up fraud as they usually have a tax agents' focus - not an audit focus.

Fraud – Recent Development

The Association of Certified Fraud Examiners' 2018 annual report1 on "occupational fraud" (defined as fraud committed against an organisation by its own officers/directors/employees) shows that from 2,690 cases of occupational fraud from 125 countries in 23 different industries:

- Asset misappropriation schemes are the most common but least costly, at a median loss of US$114,000.
- Small businesses lost almost twice as much per instance of fraud.
- Nearly half of frauds were attributed to internal control weaknesses.
- Offenders who were employed for over five years stole twice as much as those whose tenure was under five years.
- Most victims recovered nil.

At least one behavioural red flag of fraud was shown in 85 per cent of cases, for example:

- Living beyond their means.
- Financial difficulties.
- Having an unusually close association with a supplier or customer.
- Unwillingness to share duties.
- Family problems.
- "Wheeler-dealer" attitude.
- Refusal to take vacations.
- Data monitoring/analysis and surprise audits were correlated with the most significant reductions in fraud loss and duration.

The association also found that the most common reason for asset misappropriation is a lack of management review.

Conduct measures to be taken:

- Have regular and meaningful conversations with employees to uncover the red flags listed above.
- Implement random and frequent spot checks of business transactions.
- Ensure two-party authorisation on EFTs.
- Director or owner authority on payments made above a certain amount.
- Use the accounting software's reporting to identify anomalies and reconciliation issues.

Business owners should be vigilant to the real risk of employee fraud and work with their professional advisors to design and implement appropriate measures to manage that risk. Those measures need regular review. Changes in the business environment mean these measures need updating.

Bookkeeper Fraud

A national study into fraud by bookkeepers employed at small and medium-sized businesses has uncovered 65 instances of theft in more than five years, with more than $31 million stolen.

Fifty-six involved women, with nine involving men. However, male bookkeepers who defrauded their employer stole three times, on average, the amount that women stole.

The study looked at criminal convictions recorded across Australia over a 6-year period. A total of $31,379,761 was stolen in that period at an average of $482,766 in each instance.

Nothing excuses a breach of trust, but from personal experience, women bookkeepers steal due to pressing financial needs. Let us be clear – the overwhelming majority of bookkeepers are decent, honest people who exercise their duty of care to their employers or clients. However, as fraud is becoming increasingly prevalent, we suggest the following steps:

- Establish a procedure policy for the receipt of payments, ensuring an employee and the bookkeeper reconcile amounts owing with the customer ledger.
- Limit the scope of financial transactions the bookkeeper can undertake solely (electronic bank transfers, BPay, sole cheque signatory).
- Routinely, randomly examine financial transactions.
- Beware the bookkeeper who insists on not delegating financial account keeping functions and rarely takes leave.
- Keep a careful eye out for any unusual general ledger accounts to which your accounts payable system is posting.

Most fraud can be prevented with the proper controls in place. It is prudent risk management to take the risk of fraud seriously. The cost of prevention is usually a fraction of the possible loss if the fraud was not prevented.

Other ideas to minimise the likelihood of fraud:

- The real danger involves the small business that has owners that take a weekly draw or wage and are very hands-on and heavily involved in the business,
- Such people tend to develop faith in the bookkeeper relying on them because they cannot stand paperwork,
- While the bookkeeper may keep the office organised and tidy, they may also be robbing the owner's blind!
- This is because the owner's content with their weekly draw (for now) often do not conduct any checks,
- At the very least, request monthly Profit and Loss statements and balance sheets for review,
- You may have a limited understanding of accounting but do not be afraid to ask questions. At the very least, this puts the bookkeeper on notice that you have an active interest in the firm's finances,

Focus on sighting:

- Bank balances (Reconciliations)
- Aged Accounts Receivable lists (Debtors)
- Aged Accounts Payable lists (Creditors)
- Stock Levels (if applicable)
- Reconcile these back to the balance sheets.
- If there are irregularities, you may wish to get your public accountant/tax agent involved. They will then have an audit focus.

Internal Controls and the Safety of Money

Fraud control should always be an essential consideration when designing any business system. Many small business insolvencies continue to attribute their insolvency, at least in part, to employee fraud. We would all prefer to believe that all our employees are completely honest, but that is rarely the case.

Employees steal for various reasons, but three factors need to be present in an environment for fraud to be committed.

- a need – the internal reason for the person to steal.
- the opportunity to do so.
- the belief that they will not be caught.

Internal controls are both meant to limit (I doubt that you will ever eliminate) the opportunity, and to portray the position that a fraudster will be caught and prosecuted should be carefully considered.

In this age, Electronic Funds Transfer (EFT) payment processes should be carefully considered. What controls, particularly fraud controls, should be embedded in the process?

Focus on separation of duties, one flow of information, authorisations, and contemporary recording of the transaction. This may not be practicable in a small business, but you should be aware of "best practice" because the cost of complacency could be your business survival.

Solutions

- At least three people are involved in the preparation, authorisation, and processing of any payment.
- Each person will only handle the transaction once.
- The details cannot be changed after authorisation.
- The system automatically records the transaction as it is being done.
- The system automatically notifies all parties involved that the transaction has been done as soon as it is done.
- The system records the transaction and saves a pdf version of the transaction on the computer file and in the audit trail.

DIRECTORS DUTIES – ASSET PROTECTION

Company Directors are under a positive duty to ensure that the company does not incur a debt whilst it is insolvent or does not become insolvent by incurring that debt.

Accordingly, Company Directors are becoming increasingly exposed to personal liability for business debts.

Further executions of personal guarantees by directors have become commonplace and essential today if one wanted to continue in business. This means that directors of small to medium-sized businesses have exposed themselves to personal liability by guaranteeing the debts of their companies. Demands on the directors will normally proceed when there is a default under a personal guarantee.

Since 1993 the Australian Taxation Office also has had its recovery powers for company debts extensively increased as the ATO can now place a penalty on directors equal to the tax debt outstanding for the company pursuant to Section 588 FGA of the Corporations Act. This provision allows the ATO to be repaid by the directors for certain taxation liabilities of the company.

Common-Law and Contractual duties are owed by directors governed by Case Law and their individual employment contracts.

The Common Law duty of care, skill, and diligence stems from the law of negligence and the relationship of proximity between the director and the corporation.

Rules of equity also impose a number of duties on directors by virtue of the fiduciary relationship between directors and the company. A liquidator can bring proceedings for breach by a director of a duty owed to the company that would otherwise be exercisable by the company for the insolvency.

So effectively, corporate structures are not the protective instruments they once were to secure against commercial risk. It is more evident that directors are personally exposed in the case of insolvency. A more litigious society has made unforeseen claims more of a reality, and consequently, directors need to protect themselves and their assets from adverse situations.

D & O (Directors and Officers) Insurance

There may be little benefit to an insolvency practitioner or creditors in pursuing directors unless the directors are covered by D & O insurance giving the practitioner access to the funds of an insurance company.

However, there are a number of standard exclusions from D&O policies that significantly restrict the amount of ambit of their operations. These include:

- prospectus-type liability exclusion will often be of importance to directors of companies who propose to embark on a public offering.
- Professional indemnity exclusion excludes cover for claims alleging a breach of duty other than the professional duties owed by a director.
- Insured versus insured exclusion excludes claims brought by one person covered by the insurance against another, including by the company against a director. This is a significant exclusion because a director's duties owed to the company itself and actions thus brought by the company are a significant potential source of liability. Many D & O policies contain an exception to the insured versus insured exclusion.

This is to prevent the manufacturing of a claim, for example, by the directors of a company breaching a duty and voting to sue themselves to get damages for which the company is insured.

D & O policies typically include an exclusion to extend cover to claims brought in the company's name at the instigation of a receiver, administrator, or liquidator.

D & O insurance in the context of insolvent trading claims?

Section 199B and 199C of the ACT show that a company must not pay an insurance premium against a liability arising out of conduct involving a wilful breach of duty. So, as long as the D & O policy excludes such claims from its ambit, a company can take out effective D & O insurance for its directors and officers.

Sections 199A prevent a company from indemnifying a director against liability incurred for a pecuniary penalty order or a compensation order under s1317H.

Steps directors take to protect their assets.

1. Planning your personal asset structure is fundamental to preventing assets from being disgorged by a liquidator of your company.
2. Structure ownership of your personal assets not only for taxation purposes but also for your asset protection purposes. This needs to be undertaken when you are solvent. The insolvency laws only capture transactions, where it appears that they were executed when the person had or ought to have known of their company's insolvency or themselves.
3. Directors should avoid having control of the entities that their assets are held. One may still be held to be the beneficial owner of assets when it can be proven that one had control over the structure holding the assets.

Solutions

These solutions are by no means exhaustive but somewhat indicative of some of the strategies that may be employed. The application of these strategies will be dependant on the individual's circumstances.

1. Transfer property such as your residential property to a low-risk party such as your spouse. Your spouse cannot be a director of your company if this strategy is undertaken. Recent case law has determined that even directors who take no active role in their company's management cannot avoid insolvent trading liability simply by pleading that they did not understand their role and responsibilities. This step is less effective given recent bankruptcy law changes, and caution should be exercised.
2. Transfer property into a discretionary trust allowing your family to be the beneficial owners of your property. If you die and your spouse commences a relationship with someone else, this mechanism also protects your property. That person may not be able to claim a share in the property subject to the trust as your spouse may not be the beneficial owner of the property. Bloodline Testamentary Trusts may be useful in such situations.
3. Placing contributions with a Superannuation Fund. Superannuation funds have provided one of the best returns over the long term compared to the stock market and property.
4. Separate your trading entities from your asset holding entities. A basic example would be to place your assets in a discretionary trust such as your residential property whilst operating your business as a company.

Estate Planning

If you are entitled to receive an inheritance, then your inheritance will form part of your divisible assets amongst your creditors in the event of your bankruptcy. Accordingly, it is prudent to advise those who are proposing to bequeath property to you to set up a suitable trust structure to prevent any inheritance potentially becoming available to your creditors in the event of your insolvency. Again, in these instances, a Bloodline Testamentary Trust is a valuable tool.

Lastly, as the saying goes, "prevention is better than cure" is very appropriate in these circumstances. However, in many instances, insolvency was unforeseen and could not have been prevented, especially in the prevailing volatile economic conditions. Accordingly, being prudent about one's financial affairs whilst solvent is becoming an issue we may all have to deal with.

Conclusion

Directors need to be aware of their duties and obligations of holding office.

Business, by necessity, carries commercial risk. If they structure their affairs properly, directors can avoid losing all their assets if there is a commercial disaster. Although the above strategies protect directors in civil actions, there is no such protection from criminal actions. Directors must at all times ensure they are undertaking their duties diligently and with due care.

WITHDRAWAL OF CASH FROM BUSINESS

Asset protection advantages may be gained by extracting funds from a business structure (e.g., as dividends) even if cashflow requirements dictate that the funds be loaned back to the business. The loan-back of funds may be on a secured basis giving the proprietor priority over unsecured creditors in the event of business failure.

Some of the techniques to withdraw more cash from business interests include:

- distributing all profits out each year
- increasing proprietor remuneration
- increasing superannuation benefits
- reducing paid-up capital
- sale of shares to children or employees working in the business.

Another area requiring innovative ideas as they relate to personal financial planning is the area of income tax planning. Many of the techniques available to more liquid individuals may not be available to or appropriate for business owners. A few of the planning techniques which are most relevant to these individuals are:

- leveraged purchase of business assets (e.g., real estate, machinery) leased to the business entity.
- deferred compensation arrangements (e.g., superannuation)
- insurance arrangements (e.g., “keyman”)
- using a business vehicle that could provide better tax rates and, or maximise income splitting flexibility (e.g., a company or a discretionary trust)
- holding income-producing assets in a discretionary trust separate from the business vehicle.

DEVELOPMENTS IN BANKRUPTCY LAW

Unincorporated business owners and professionals in partnerships are likely to be the worst affected by bankruptcy rules. The rules allow a trustee in bankruptcy to access the family home on behalf of creditors even if only one spouse goes bankrupt, regardless of whose name the property is in.

Anyone in this situation should review existing structures.

The period before bankruptcy that assets are accessible to a bankruptcy trustee – is four years for so-called “under market transactions”, which apply to assets transferred to relatives, including a spouse, by way of a gift or sale that is less than market value,

In addition, under the new section 139EA of the act, where a home is in the name of a spouse (as is common asset-protection practice), the bankruptcy trustee could claim the mortgage repayments and the increase in the property’s value for up to five years before the bankruptcy. This could occur in circumstances where the:

- Home is in the wife’s name for asset protection.
- The husband has been making financial contributions by paying off the mortgage.
- Husband used or at least obtained an indirect financial benefit from the property; or
- Value of the wife’s interest in the property has increased because the mortgage has decreased and the amount by which the property has increased.

Alternatively, suppose the property was bought using resources provided by the spouse being bankrupted, then, under the new section 139DA. In that case, it appears the court can make an order that whole interest in the property vests with the trustee in bankruptcy.

In other words, the trustee gets the house, even if it is in the spouse’s name. And that is not all. A recent High Court decision has taken the view that the two spouses own the family home – jointly and equally, regardless of who paid for it.

That occurred on the back of a few rogue barristers who rarely completed their tax returns, paid little or no tax and declared themselves bankrupt with no apparent handicap to continuing in professional practice – not only that, but their spouses expected to hold on to the family assets in their own name.

In particular, the Cummins case concerned a bankrupt barrister who did not lodge a tax return for 40 years.

According to the ruling: “Where a husband and wife purchase a matrimonial home, each contributing to the purchase price, and the title is taken in the name of one of them, it may be inferred that it was intended that each of the spouses should have a one-half interest in the property, regardless of the amounts contributed by them.”

In this case, the good news is that a blameless spouse would still own 50 per cent of the home regardless of the names on the title or the bankruptcy laws.

That would indicate that the spouse’s half would not be at risk, though the bankrupt spouse’s share is.

Future cases will reveal how the bankruptcy law changes and the High Court decision would be applied in practice.

Businesses could safeguard themselves against this ruling by owning a property under a family trust with a corporate trustee. But that route also comes at a cost by way of extra taxes when buying and selling the property.

It should be noted that the new bankruptcy provision takes into account the direct and indirect contribution of a bankrupt spouse to the home.

Structuring to distinguish between working income received by a bankrupt spouse and "ownership income" received by a non-working spouse from a business could act as protection.

This applies to partners in professional firms, too, as long as there is no personal income attributed to the working spouse.

If properly structured, the non-working spouse can receive income from the business as an owner as long as that income is not directly attributed to the working spouse's efforts. This means the business carries on regardless of whether the working spouse is involved or not.

This could be effective where the wife receives income from her share of the business and makes all the mortgage repayments on the family home.

In this case, the wife has used her ownership income to pay for the house and its maintenance. Any income received by the husband is used for investments or holidays but not for the home.

The mistake business owners or professionals continue to make is to put everything in the wife's name. Still, then they continue to receive all their working income in their own name and use it to make the mortgage repayments.

The way to get around the new bankruptcy act provisions, particularly Sections 139, which relates to direct or indirect financial contributions – is to distinguish as much as possible ownership income from remuneration for services.

It was inevitable that more cases would test the Cummins decision, and the first notable one is official Receiver v Huen (2007) FMCA 304.

A property was purchased by Mr & Mrs Huen in joint names in August 2003. The family moved into the property on 25 August 2003 before Mr Huen left in early September of that year, signing an "agreement" on 1 September 2003 that Mrs Huen owned 100% of the property.

Mr Huen became bankrupt on 22 August 2005. Less than two months later, Mr & Mrs Huen applied for a divorce, which order took effect from 31 January 2006.

The Official Receiver (OR) argued the "agreement" was void under section 120 of the Bankruptcy Act for lack of consideration. Alternatively, the OR argued that following the Cummins case, at all times, the bankrupt and his Wife held a one-half interest in the property. And that the Cummins principle overrides any equitable doctrine of exoneration, defeating the wife's argument that various amounts that she alleged had been borrowed against the property to lend to the husband's business should not be considered.

The court agreed with the trustee that the agreement was ineffective and, or void against the trustee. The Federal Magistrate applied the Cummins principle and found no evidence to rebut the presumption of equal ownership.

As a result of the application of the Cummins principle, the Court held that "only one result can ensure, that is, that up to the time the joint tenancy was severed by Bankruptcy the Bankrupt and the Respondent each had a one-half share in the Melville Property, both legally and equitably. On bankruptcy, the bankrupt's one-half share in the property vested in the trustee in bankruptcy.

Significantly, the Court made two further observations:

1. Firstly, without discussing why, Federal Magistrate Lucev held that: "The Court is not persuaded that the principle in Cummins is a rebuttable presumption." (At 37).
2. Secondly, the Court agreed with the trustee that: "In the Court's view, the application of the Cummins (sic principle) cannot co-exist with the doctrine of exoneration."

The extent of these observations will no doubt be considered in later cases. The wife failed to prove her husband received the monies borrowed against the property, so the dismissal doctrine was not relevant. However, suppose his Honour's statement is correct. In that case, Bankruptcy Trustees will be able to recover the bankrupt's interest in the matrimonial property without having to account to the non-bankrupt spouse for the common law charge, which the doctrine of exoneration would in certain circumstances otherwise apply.

In general terms, the case confirms the Court's willingness to follow the High Court's lead. i.e., ignoring the specific contributions the husband and wife made to the purchase of matrimonial property in favour of a general finding that each holds a one-half interest in the property, which half will vest in the trustee in the bankruptcy of either of them.

However, it should be noted the principle of the doctrine of exoneration can change respective interests in real property ownership, depending on the conduct of one or more of its owners. For instance, when a joint owner of real property borrows funds and secures them against the real property, they use them for their own benefit and exclude another owner. In applying the doctrine, each owner's interests in the property's equity are adjusted.

This can significantly impact a bankruptcy trustee, particularly where, despite a bankrupt being a registered owner of real property with equity, they have no interest in that equity because they previously borrowed additional funds and secured them against the property. It frequently applies where a person has borrowed against the family home held jointly with someone else to fund a business, and the person who has benefited from the funds is subsequently faced with bankruptcy.

The doctrine applies where a number of parties are registered owners of real property but where borrowed funds secured against it benefit some owners, but not all.

For example, Michael and Clare, husband, and wife, own their home, subject to a mortgage. The mortgage is for the benefit of both. However, Michael takes out an additional loan for his own benefit and secures it against the family home. Under the doctrine, Michael's additional loan is for his benefit alone, and Clare's interest in the property's equity is adjusted to reflect this. The doctrine applies in any such similar instance between co-owners regardless of relationship status.

COMMISSIONER OF TAXATION V BOSANAC (NO 7) [2021] FCA 249 (22 MARCH 2021) (MCKERRACHER)

The doctrine of exoneration and various other "presumptions" were tested in the Bosanac case and showed the Commissioners willingness to test the law in this area. Let us consider a brief summary:

- Mr and Ms Bosanac were married in 1998.
- Mr Bosanac described his business activities as a 'self-styled venture capitalist'.
- In May 2006, Ms Bosanac purchased a property in Perth, Western Australia, for $4,500,000. She paid a $250,000 deposit from a joint bank account held with Mr Bosanac.
- In November 2006, the property sale settled, and the title to the property was transferred into the name of Ms Bosanac as the sole proprietor.
- The property was the family home for Mr and Ms Bosanac and their three children.
- The purchase price was fully funded by two new joint loans from Westpac Bank: $3,500,000, the other of $1,000,000. The loans were secured over the Perth property and other property they jointly owned.
- In mid-2015, Mr Bosanac moved out (they had formally separated in 2013).
- In 2015, the Commissioner of Taxation audited Mr Bosanac's financial affairs and discovered that he had not lodged tax returns from 2006 to 2013.
- On 12 August 2016, the Federal Court entered judgment for a tax debt of $9,344,111.89 plus costs against Mr Bosanac.

Here it should be noted the wife was the sole registered proprietor of the family home. This did not stop the Commissioner from attempting to enforce the judgment against the Perth home.

Contending there was a "presumption of resulting trust" where Mr Bosanac had a 50% beneficial interest in the home. Ms Bosanac relied on the "presumption of advancement", successfully claiming a 100% beneficial interest in the home.

Presumption of resulting trust

A "presumption of resulting trust" can arise when a person purchases property in the name of another or their joint names. Still, the other person contributes none of the purchase money, or the contribution is by two people jointly. Still, the property is registered in the name of only one person.

Without evidence to the contrary, a resulting trust may arise because "it is presumed that the person who contributed to the payment of the purchase price did not intend to gift their contribution to the other person".

Presumption of advancement

In some relationships, such as marriage, it is presumed the husband intended to gift the property to his wife. This presumption is archaic as it precludes females from gifting the male in marriage; it excludes de facto partners and same-sex marriages.

In the Bosanac case, the Commissioner argued that the presumption of advancement did not apply to a marital home; and was rebutted by evidence of the husband's intention when purchasing the property.

The Commissioner's arguments

- The Commissioner claimed it would make little sense as a co-borrower to owe a substantial debt if Mr Bosanac did not intend to retain his beneficial interest.
- Mr and Ms Bosanac took out two other loans, secured by the Perth property's mortgage, which Mr Bosanac used to trade his shares.
- Mr and Ms Bosanac shared bank accounts and other property assets. It follows the same approach to ownership that would extend to the family home.

The Court's findings

- The presumption of advancement can apply to the matrimonial home.
- The fact that Mr Bosanac incurred a substantial loan debt did not conclusively show he intended to retain a beneficial interest. Where a bank requires two signatures, the person seeking to rebut the presumption of advancement is burdened with showing that the other person's signature was merely a formality instead of evidence of an intention to confer a beneficial interest on that person.
- Although the loan Mr Bosanac used for share trading was secured by the property, Ms Bosanac explained she had no issue with this because she trusted her husband. This loan was also secured by a separate property where Ms Bosanac was the sole registered proprietor.
- The Court observed that Ms Bosanac's registration as the sole owner might have been made for many reasons, but the evidence as to the intent of either party was very scant. Ultimately, the Court held that the Commissioner had not provided sufficient evidence of Mr Bosanac's intention to retain a beneficial interest in the property.
- While the Bosanac case involves a creditor claim (the ATO), the issues apply to bankruptcy scenarios where a co-owner is bankrupt. The bankruptcy trustee may claim an entitlement to the property. In the Bosanac case, the property was acquired several years earlier. No evidence suggested that the property title's transfer prevented, hindered, or delayed the property being available to Mr Bosanac's creditors.
- To improve the relevant spouse's prospects of relying on the presumption of advancement, it is prudent, at the time of the purchase, that the husband enters into a deed confirming he is making a gift to his wife, he has no beneficial interest in the property and, if a joint borrower on the purchase loan, that he has no rights of contribution against the wife in respect of the loan and mortgage.

Suppose mortgage payments are paid from the wife's income, then that would be very helpful. The Commissioner is testing the waters... and there is no room for complacency.

Bosanac's case highlighted that the presumption of advancement remains an effective asset protection strategy if there is no evidence to suggest that the husband retains a beneficial interest in the property or has done so with the intention of defeating creditors' claims.

When it comes to asset protection, the family home is nuts and bolts stuff. If purchasing a new family home, do not assume it is sufficient to put the asset in the name of the "low risk" spouse. Consider your unique circumstances and seek specialist advice. Existing arrangements should be carefully reviewed.

CONSEQUENCES OF JOINT TENANCY AND TENANCY IN COMMON ARRANGEMENTS

On the death of one joint tenant, the asset automatically passes to the other or others, regardless of the terms of the will of the joint that died.

If a joint tenancy is severed (that is, converted to a tenancy in common), each owner can then direct how their share in the property is passed following their death by making provisions in their will.

Example 1 - Tim and his sister Tiffany bought a small investment property together as joint tenants before either was married. After getting married, Tim decides to change the arrangement to a tenancy in common so his interest could pass to his wife rather than his sister on his death.

Example 2 - Tim and Betty purchased their family home as joint tenants. A few years later, Betty establishes a business and is concerned about losing everything if the business fails. While Tim is alive, Betty would prefer the house to be owned in his name.

If Tim dies, Betty does not want the house to be owned 100% in her name. Her preference is for it to be in a testamentary trust. Betty and Tim should sever the joint tenancy arrangement and convert their ownership to tenants in common so that Tim can at least deal with his interest in the property under his will.

As there is no change in ownership of the property, transfer duty and tax are not payable. The only transaction cost is generally Government registration fees.

There can be significant differences in the treatment of real property upon a person's death, depending upon whether their ownership is structured as joint tenants or as tenants in common.

We need to understand how property ownership is structured and ensure that it is appropriate for your circumstances.

DISCRETIONARY TRUST USES GIFT AND LOAN BACK

The 'gift and loan back' approach involves the owner of an asset gifting their equity in the property to a family trust (or low-risk spouse).

The family trust then lends money to the owner and takes a secured mortgage over the property.

For example, assume that Tony holds 100% of an investment property and the home's current value is $1,600,000. There is an existing mortgage of $600,000.

Therefore, Tony's equity is $1 million.

Tony gifts the amount of equity in his property to a trust.

The trust subsequently lends the amount back to Tony and takes security over property.

Under a gift and loan back, any net equity in a property is protected by a registered mortgage. If the property is mortgaged to a bank, the family trust will take a second registered mortgage. The bank still has priority under its first registered mortgage.

If the property is unencumbered, the family trust will take a first registered mortgage. In both cases, the total value of the property is protected by registered mortgages.

The gift and subsequent loan would ideally involve the physical transfer of funds through electronic funds transfer. If this is not possible, other alternatives may be available depending on the circumstances.

If the value of the property increases or debt to an external financier is reduced, the loan arrangement may be 'topped up'.

This can be achieved by Tony gifting further amounts equal to the increased equity amount to the trust. It is important to note that the gift of the increased equity will be considered a separate transaction for the purposes of bankruptcy clawback period rules.

The advantages of utilising a gift and loan back, compared to a straight transfer of the property, can include:

- The arrangement achieves broadly equivalent protection for the asset compared with a straight transfer; and
- There is no change in the legal ownership of the property. As such, transfer duty and capital gains tax usually do not apply. The only transaction cost is a relatively small mortgage registration fee.

The disadvantages of utilising a gift and loan back approach, compared to a straight transfer of the property are:

- The arrangement is more complex than a simple transfer and involves the preparation of additional documentation, including a deed of gift, loan agreement and security/mortgage documentation.
- It only protects the amount of net equity in the asset at the time of the gifting. It does not protect against increases in the value risk the individual holds in the asset.

The gift and loan back strategy may be an effective method of increasing asset protection where a direct transfer of an asset is not desirable or appropriate, for instance, due to prohibitive tax and stamp duty costs.

Of course, the standard Bankruptcy "clawback" provisions apply to arrangements such as this.

DIRECTORS' GUARANTEES

It was Reg Ansett who famously told his son Bob "never give a personal guarantee." Most of us do not have a choice.

However, it is essential to note who has given personal guarantees within a family group, affecting asset protection planning decisions.

REGISTERED CHARGES

Often asset protection is difficult for families who have given personal guarantees and encumbered the family home. The truth is that many small businesses in Australia are under capitalised.

Others are in a more enviable position. They may have been in a position to advance their own loan funds to a family company being that entity's primary lender.

A simple and effective way to secure their position and be 'first in line' when the creditors are being paid (in the event of failure) is to register a secured charge over the company's assets. A lawyer can prepare the documentation and ensure the change is registered with ASIC.

Some lenders take securities over assets to protect their exposure to borrowers. Most of these lenders are aware that Section 262 of the Corporations Act requires certain charges over company assets to be registered with the Australian Securities and Investments Commission (ASIC), and these include:

- floating charges
- charges on personal chattels (this does not extend to certain ships which require separate registration)
- changes over goodwill and patents or trademarks
- changes over book debts; and
- a charge over crops, wool, or stocks.

A charge over land is slightly different. They are registered in a State or Territory Lands' Titles Offices and do not require registration with ASIC.

A fixed and floating charge over all a company's assets would also cover any real property owned by the Company. To be safe, lenders should ensure that a mortgage is lodged on the certificate of title as well as lodging the charge with ASIC. Otherwise, the lender may fall behind other lenders that have registered their charges on the property's title.

Details on any charges that require registration must be lodged with ASIC within 45 days of its creation.

263(1) Where a company creates a charge, the company must ensure that there is lodged, within 45 days after the creation of the charge:

(a) a notice in the prescribed form setting out the following particulars

A charge is voidable against a Liquidator or Administrator if registered outside the 45-day period unless registered more than six months before an appointment. It is possible for a lender to apply to have the Court extend the 45-day period. Still, a creditor will need an excellent reason why it was not registered in time, and these applications are not automatically granted.

266(1) Where:

(a) an order is made, or a resolution is passed for the winding up of a company; or

(b) an administration of a company is appointed under section 436A, 436B or 436C; or

(b.a) a company executes a deed of company arrangement.

A registrable charge on property of the company is void, as security on that property, as against the liquidator, the administrator of the company, or the deed's administrator, as the case may be, unless:

(c) a notice in respect of the charge was lodged under section 263 or 264, as the case requires:

(i) within the relevant period; or

(ii) At least six months before the critical day; or

Charges are put in place to secure a company's indebtedness to a lender. The charge gives the lender tangible security over a company's property should the loan fall into default. It is a form of insurance. If lenders fail to register a charge correctly, the charge may not be worth the paper it is written on, and the loan may be unsecured.

The Use of Liens

Liens can entitle a creditor to hold goods hostage until payment has been received in some cases to assert this right in priority to secured creditors with security perfected under the PPSA.

Usually, a perfected security interest has priority over all other unperfected security interests in the same collateral under section 66 of the Personal Property Securities Act (PPSA).

However, this is not always the case. Under section 93 of the PPSA, a common law or a statutory lien over goods lives outside the PPSA priority regime. It has priority over all security interests in those goods if:

a. the materials/services provided which gave rise to the lien were provided in the ordinary course of business.

b. no other Act prevents the lien from having priority; and

c. The lien holder did not know that a security agreement relating to those goods prohibited the creation of the lien.

Generally speaking, a lien allows a person to retain possession of another's property pending satisfaction of the lien holder's claim against that person.

Examples of statutory liens include the unpaid seller's lien under the *Sale of Goods Act 1908* and the carrier's lien under the *Carriage of Goods Act 1979.*

Common law liens can be 'general' or 'particular'. A 'general' lien allows a person to retain possession of goods until all sums payable by the owner of the goods are satisfied, not just sums payable regarding work performed on those goods held hostage.

These are relatively rare and must be established by strict proof of custom or usage - an example is a solicitors' lien which allows a solicitor to retain a client's documents until payment of all debts owed to the solicitor by the client.

In contrast, a 'particular' lien only secures obligations incurred in respect of the hostage goods. An example is a 'workers lien' regarding payment for work done to improve a chattel, such as a mechanic's right to hold your car until you have paid for the work done on it.

The following cases consider liens and their place in the personal property securities pecking order.

McKay v Toll Logistics (NZ) Limited (HC) [2010] 3 NZLR 700; Toll Logistics (NZ) Limited v McKay (CA) [2011] NZCA 188; Stockco v Walker HC Napier CIV-2011-441-110, 24 June 2011

Practical tips

- Secured creditors should ensure that their written security agreements prohibit the creation of liens over the secured property and, where commercially practical, could give notice of such prohibition to any third parties that commonly take possession of assets for improvement from the debtor.
- Where an owner passes possession of goods to another party to work on or improve the goods, the owner may prevent a lien arising by ensuring the obligation to pay for the improvements arises after the goods are returned.

NOT TAKING SECURITY OR ADEQUATE SECURITY DUE TO FAULTY DOCUMENTATION

This case study clearly shows the dangers of not taking the time or expense to prepare proper legal documentation.

– M Pty Limited operates a restaurant from premises they own.

– They find a buyer for the restaurant, JT.

– JT is a sole trader and needs some assistance with funding the purchase.

– He pays $190K for the restaurant, of which $130K is vendor financed by M Pty Limited.

In addition to a contract for the sale of the business and a lease, a Deed is entered into between the parties in respect of the vendor finance arrangement.

JT got into tax trouble and went bankrupt. Having entered into various agreements outlined, M Pty Limited has surely adequately protected and secured their position in the event of the default. Sadly, this is not the case.

The terms of the Deed (which is pre-PPSA) appear reasonably standard for such a vendor finance arrangement, but clearly, the document has not been tailored to reflect that the Purchaser/Borrower is a sole trader.

The relevant section in the Deed in relation to the provision of security reads as follows:

If either the Borrower or Guarantor is a company, then each of them agrees if requested in writing by the Lender, within 21 days of such request and at the Borrower's own cost and expense to give to the Lender a first fixed and floating charge over their assets referred to in the second schedule and undertaking duly signed and to cause notification of such charge to be registered in the office of the Australian Securities and Investments Commission and otherwise as may be required.

So, no security but there surely should be a guarantor to the agreement? Not the case, in that, using a Deed intended for a corporation, the guarantor of the Borrower's obligations is none other than the Borrower himself!

M Pty Limited became an unsecured creditor in a bankruptcy. They saw a small return on their outstanding vendor finance when they could have been a secured creditor with a third-party guarantee.

All in all, a costly mistake when any competent lawyer could have dealt with this properly...

INTER-ENTITY LOANS

Some people have their asset protection issues for non-business assets all sorted with a 'low-risk spouse' or, better still, an asset protection trust.

Their concern with asset protection lies within their trading entities and protecting these business assets from creditors.

This may be achieved by carefully managing the way the trading entity is financed within the company group.

The lender should take security over trust assets – in the event of the trading entity becoming insolvent, then that security can be enforced.

Legal advice is essential to ensure all formalities are met.

It is recommended that relevant security interests be registered on the Personal Property Securities Register (PPSR). Note that only a 'security interest' over 'personal property, such as intellectual property or business assets other than a rental property, can be registered – see above commentary.

It is wise to review inter-entity loans in the context of trading conditions regularly.

THE PERILS OF LOAN ACCOUNTS

The three preceding topics lead on.

Liquidators reviewing the company's financial accounts prepared by the company's accountant are always pleased to see a debit (asset) loan account. Usually, such loan accounts are due by a director of the company. When quizzed by the liquidator, the director often is unaware of the 'loan'.

Often various transactions associated with a director are put through a loan account rather than allocated to wages or directors fees to avoid the complications of PAYG tax, workers compensation and reporting requirements. However, these sometimes frequent transactions can build up to a sizeable loan account potentially recoverable by a liquidator.

Advisors and directors alike should ensure any benefits taken by a director, whether in the form of cash wages or benefits, are accounted for as 'wages. While this may increase PAYG tax and reporting implications, it will more accurately reflect the amount being drawn by the director in benefits and avoid the building up of a sizeable loan account.

Furthermore, it will avoid arguing with the liquidator regarding why the loan account should not exist or even having to defend an action brought by the liquidator.

What we are dealing with are sloppy business practices which can have dire consequences. This leads on to our next topic – Sham Contracting.

SHAM CONTRACTING

We covered this part earlier in the edition under the heading "Contractors, Employees and Workcover."

A real danger for business owners is the notion that because an asset protection structure is in place, there is no exposure.

Sound business practices underpin such a structure, and we see above the importance of proper management of loan accounts.

It is true that directors' loan accounts often arise due to excessive drawings and not paying the business owner a consistent and realistic wage.

Sadly, this mismanagement sometimes extends to staff, with the business owner falsely treating employees as "contractors".

We have outlined the importance of proper planning and budgets, and here we see employers who believe the administration of PAYG, Superannuation and Workers' Compensation is too onerous.

Realistically such a business has little prospect of long-term success.

Exposures include but are not limited to:

- ATO demanding pay as you go tax (PAYG) be paid after the event
- Superannuation Guarantee Charge assessments
- The business is liable for Workers Compensation claims
- If over the relevant threshold…. payroll tax assessments at state government level.

We can now add the Fair Work Ombudsman (FWO) to the list with its continued focus on Sham Contracting. The below recent cases indicate the Courts are now prepared to impose substantially harsher penalties than we have seen in the past.

We direct you to the following cases:

- Director of the Fair Work Building Inspectorate v Linkhill Pty Ltd (2014) FCCA 1124.
- The Director of The Fair Work Building Industry Inspectorate v Linkhill Pty Ltd (No.7) (2013) FCCA 1097 (20 December 2013); and
- Fair Work Ombudsman v Global Work and Travel Co (2015) FCCA 495.

Such adverse assessments can all come at once, rendering a business insolvent, and if the director owes the business money, they are personally liable!

One last observation…the most common cause of personal and business insolvency is the lack of provision for taxation liabilities. Many people are simply incapable of doing this, and if an employer is falsely treating an employee as a contractor, you may be placing them in harm's way. It is not just failing to comply with the Statutes – employers have a duty of care to their employees.

BUSINESS BUDGETS BEAT BANKRUPTCY

Leading Insolvency expert Ivor Worrell has over 41 years of experience and has been involved in thousands of insolvencies, and has observed a close relationship between business failure and a refusal to budget.

He observes the start of the financial year is the ideal time to prepare meaningful budgets.

Budgets assist in:

- determining direction
- forecasting outcomes
- allocating resources
- promoting forward-thinking
- turning strategic objectives into practical reality
- establishing priorities
- setting targets in numerical terms
- providing direction and co-ordination
- communicating objectives, opportunities and plans to various managers.

All these things are functions that failed businesses have usually bypassed. Not all businesses with budgets prosper, but most businesses without budgets will fail.

Following are the elements of a good business budget.

Soundly based budgeting principles:

- realistically reflects external and internal factors…it is not wishful thinking
- detailed and comprehensive - all aspects of the business incorporated
- recognises seasonal fluctuations
- consults with stakeholders
- provides for cash flow forecasts
- allows for ease of comparison to actual.
- reflects the enterprise's policies and investment criteria.

As we have just started a new financial year, now is an excellent time to prepare a budget.

IS YOUR BALANCE SHEET ACCURATE? COVID-19 MAKES THIS MORE IMPORTANT THAN EVER

Ensure your debtor's ledger is accurate and current. Focus on converting those invoices into cash.

Accounting practitioners will tell you a common theme when reviewing those balance sheets is:

- The debtors often make up a substantial portion of the business's assets.
- Rarely are the debtors accurate or reflective of the actual recoverable balance.

This results in the business's balance sheet looking much better than it actually is. This is a dangerous position to be in because while there may be some COVID-19 safe harbour protections from insolvent trading and an extension of the six-month moratorium on creditors being able to wind up a company, exposures for a director's personal liability remain. These include personal liability for:

- personal guarantees
- the Australian Taxation Office's (ATO) director penalty notices (DPN),
- director's duties breaches.

To procure an accurate balance sheet, review the debtors' ledger and identify any bad debts to be written off. These include:

- Aged debtors—it's not unheard of to have debtors on the ledger 12-18 months old. Consider whether these are recoverable.
- Fictitious accounts / false invoices.
- Debtors simply titled "cash".
- Mysterious debtor-loan accounts - (usually "window dressing" at financial year end).
- Friends and family loan debtors that will not be collected.
- Confusion between "work in progress" and debtors.
- Prepaid customers appearing as debtors.
- Factored debtors that are no longer the business's debtors to recover.
- Debtors who are known to be disputed and remain on the accounts.
- No structured debtor recovery process.

Once the debtor's ledger is accurate, work hard to convert your debtor's ledger into cash. The following measures should be considered and actioned if appropriate:

- Check your terms of trade and take immediate action.
- Do not automatically extend credit terms.
- Obtain security or a personal guarantee.
- Make it very clear to your clients that you do not stand for late payments. Be persistent and follow up, follow up, follow up. Personal and direct contact is your best opportunity here.
- Give options to your debtors to find a solution. Settlements, payment arrangements, discounts, all these options are more cost-effective than litigation or liquidation.
- Engage stop supply or cash-on-delivery tactics.
- Outsource the debt collection process to a professional. While there will be a fee, but there is a greater chance of recovery.
- Litigate if necessary; recovery proceedings are a valuable tool to settle protracted claims quickly.
- Consider debt factoring/trade finance. Selling your debtors ledger can assist with immediate cash flow but comes at a cost.
- Consider trade credit insurance. If you are worried about the credibility of your debtor, discuss with your insurer/broker your options to insure against that risk.
- Initiate insolvency proceedings (last resort option) to bankrupt or wind up (liquidation). While an insolvency appointment will unlikely lead to a quick and healthy return, the mere making of the application will let the debtor know that you are serious and will often lead them to act swiftly to avoid being placed into liquidation or bankruptcy.

Different Business Structures – A Cautionary Tale

People starting in business often do not want to consider that their venture may fail. Indeed, having a positive outlook is often necessary to battle through the early years. And yet, experience tells us that giving some consideration to all possible outcomes is no bad thing.

Generally, when setting up a business structure, the first two considerations are minimising costs (including establishment costs and ongoing costs) and minimising taxation. The third consideration, which is sometimes overlooked, is what type of structure will provide the best asset protection in the event of failure.

At bO2 Corporate Essentials, we sometimes see the good and bad of business structures and what structures may have been better in hindsight. Here are a few practical examples that we have seen in recent times:

Retail Children's Store

A husband and wife had an opportunity to purchase a children's retail business.

The husband was an employed tradesman.

A simple partnership purchased the business.

The business was profitable for several years, and then hard economic times and a supplier issue caused cash flow difficulties.

The business became unviable, and after the business could not be sold, its doors closed.

As the husband and wife were operating a partnership, they were jointly and severally liable for the business's debts.

They had to sell their home, which had just enough equity to cover the creditors. They were fortunate not to go bankrupt.

Whilst there is no guarantee that a different structure may have enabled the husband and wife to save their house, their personal exposure would likely have been reduced by operating the business through a corporate structure. Although the wife could have operated the business as a sole trader, half their assets would have still been at risk.

Consulting business and Restaurant

A husband and wife were directors of a company that operated as a successful consulting business. The husband was the sole employee of the business. An opportunity arose to purchase a restaurant. A discretionary trust was established through which the restaurant would operate. The existing company operating the consulting business became the trustee of the trust. Using the company for this purpose meant it would not be necessary to spend the money on getting a new company and would also mean only one annual review cost.

However, the restaurant operated at a loss and fell behind in the payment of its tax obligations. After considerable losses, a decision was made to sell the business. Although a sale was achieved, all the proceeds from the sale were paid to the bank under various securities.

As directors of the corporate trustee, the husband and wife were both issued with Director Penalty Notices (DPNs) by the ATO regarding an accumulated PAYG withholding debt.

The directors were forced to put the company into liquidation or voluntary administration to avoid the ATO pursuing them personally for the amounts under the DPNs. The ATO debt is related only to the restaurant business.

Although placing the company into liquidation enabled the directors to avoid personal liability to the ATO, it damaged the reputation of the consulting business which the company had been operating prior to becoming a trustee of the trust.

Whilst liquidation may have been inevitable for a corporate entity operating the restaurant. The consulting business became a casualty as a result of using the existing company as a trustee when the incorporation of a new corporate trustee was required.

This would have avoided having unrelated businesses trading under the same company structure. Also, if possible, the sole director option should have been taken.

Licensed Bar and Electrical Business

Two tradesmen were operating a successful electrical business through a company structure and decided to purchase a bar. They set up a new company to purchase and operate the bar, which started to lose money.

The profits from the electrical business funded the losses. The bar continued to make losses, and as a result, both companies fell behind in their tax obligations. The landlord took possession of the premises after the rent fell behind.

Creditors of each company were pressing for payment. The directors sought advice and decided to place the bar company into liquidation.

This then left the directors needing to address their electrical company, which now had a significant tax debt as a result of attempting to prop up the bar.

Due to the electrical business being profitable, the directors could put forward a proposal to their creditors to enter into a Deed of Company Arrangement (DOCA) and therefore continue to trade. Again, the reputation of this business suffered as a result of the DOCA.

In this case, separating businesses into different corporate entities enabled the poor performing business to be isolated and the profitable business retained. But the directors almost came unstuck by the decision to support the loss-making business with the cash flow of the profitable business. Not only did this decision tend to negate the decision to separate the businesses, but arguably it was also a breach of their duty as directors of the profitable company.

And so...what is the common theme in the above three case studies and the case of the "individual trustee"?

We would suggest a lack of care and thought with a lack of willingness to incur some relatively minor expenses to ensure a proper structure.

An aversion to spending $1,000 - $1,500 could have terrible consequences.

Also, we would suggest that when a business is not profitable, do not procrastinate.

Do budgets and make objective decisions - only fund the loss-making business if you can afford to do so. Lastly, do not fund the loss-making business with the money you are holding on trust for the ATO and your staff. Here we are talking about GST, PAYG tax and Statutory Superannuation.

ASSET PROTECTION FOR THE YOUNG PROFESSIONAL

Here we consider the situation of Andrew, a single, self-employed Civil Engineer operating as the sole director/shareholder of a Pty Ltd company.

Andrew's company owns $25,000 in plant and equipment with $140,000 in cash and has $12 million in Professional Indemnity (PI) insurance.

For lifestyle reasons, Andrew would like to buy a boat for $80,000, gain an initial portfolio of shares, and then start trading some shares.

Currently, he owns no other assets and is renting his office and home. Eventually, after accumulating enough assets, he would like to become a full-time share trader.

In a litigious society, Andrew is genuinely worried about being sued if anything goes wrong on a job. PI Cover may be ineffective as insurance companies do not always pay up.

What is wrong with the current structure? Andrew is the sole individual shareholder of a company with at least $165,000 in value – possibly more if the company has any goodwill or other intangible assets. Most of us know that a shareholder is usually not liable for the debts of a company.

However, if Andrew is the personal defendant in any action, he individually owns shares worth at least $165,000, making him a potential target for litigation.

It goes without saying that as Andrew's business prospers, these figures will be much higher, and the problem will only become worse.

Arguably a company is not the ideal structure from a tax viewpoint either. Given a company pays at least 25% in company tax – to extract the funds from the company to say...purchase the boat, he could wind up paying as much as 47% in tax or run the gauntlet of Division 7A (deemed dividends).

Further, the corporate veil of a company is proving increasingly less effective, with many directors being sued personally.

Solution

Andrew has a clear firewall between two newly created trusts – one a business trust and the other an asset accumulation trust. Both have corporate trustees.

The business trust owns the business name but does not accumulate assets or cash.

With appropriate decisions made on appointors of trusts, the business risk should be contained to the business trust. If the business expands, the operations company can operate the business under licence from the trust to incur the risks involved in creating engineering designs, employing people, and not offending environmental laws.

Andrew as an individual may not be completely safe from litigation, but the bulk of his future assets, i.e., shares, investments, and boats, will be at least safe in an asset protection trust. This trust must not incur any unnecessary risk or engage in any commercial activity.

If there is any risk perceived from owning a boat regarding third party claims, then, of course, a separate entity would own the boat, and in fact, we would recommend this.

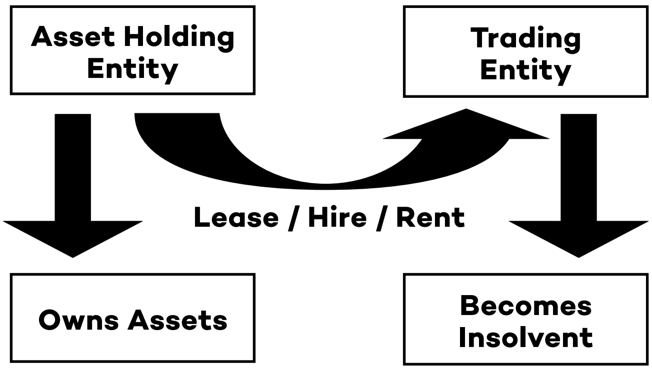
Note the structures stand 'side-by-side', and there is no subsidiary company. Avoid this situation as under Section 588V of the Corporations Act 2001, a holding company can become liable in the event of insolvent trading by a subsidiary company.

ASSET PROTECTION STRUCTURES EXPOSED UNDER PPS ACT

The Personal Property Securities Act ("PPS Act") commenced on 30 January 2012. The potential impact the PPS Act will have on commonly used asset protection structures is outlined below.

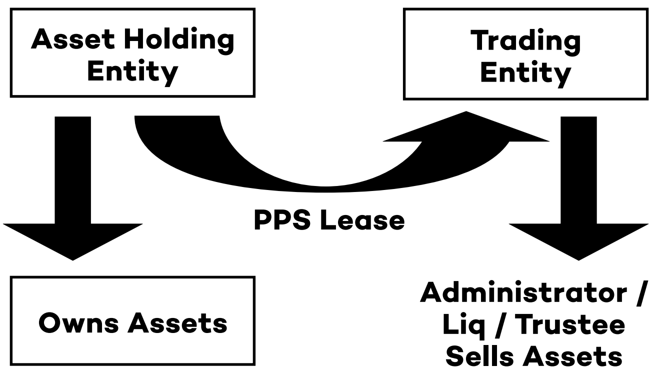
These structures usually involve a corporate group structure, where assets used in conducting the business are held in one or more "Asset Holding Entity/ies", separate from the "Trading Entity", which carries the risks associated with trading a business. The Asset Holding Entity will lease/hire/rent the assets to the Trading Entity to enable it to carry on its business. This structure protects those assets if the Trading Entity becomes insolvent as ownership vests with the Asset Holding Entity, as set out below.

Under the PPS Act, such arrangements will be deemed security interests (defined as a PPS lease) and require perfection, usually by registration on the PPS Register. Failure to perfect will negate these asset protection strategies due to the following:



– An unperfected security interest vests in the grantor on the grantor's insolvency (section 267 of the PPS Act); and

– A perfected security interest has priority over an unperfected security interest, where there are competing security interests (section 55(3) of the PPS Act).



Under Section 20, there are a number of pre-conditions to be able to perfect a security interest, including the need for a written security agreement signed or adopted by the grantor. Many of the asset protection structures as set out above are loose arrangements and not formally documented. These arrangements typically occur in small to medium family companies. The law as it currently stands dictates that ownership of those assets is paramount (as opposed to possession under the PPS Act). Under the prior legislation, the assets were generally not at risk on an insolvency event of the Trading Entity, assuming ownership could be proven.

This has now changed due to the effect of the vesting provisions on insolvency (Section 267) and the priority rules for competing security interests (Section 55(3)). The above asset protection structures must be documented in writing and perfected by registration on the PPS register based on these changes. The PPS Act contains strict timelines for registration on the PPS Register, which must be complied with.

Failure to do so means that upon insolvency of the Trading Entity, ownership of the assets will be transferred automatically to the company in administration/ liquidation of the bankrupt estate. The asset protection structure will not protect such assets. The assets would also be lost to a secured creditor who has a competing security interest (such as a bank), provided that the creditor perfected their security interest in compliance with the PPS Act.

In summary, asset protection structures as set out above will fall under the ambit of the PPS Act and require perfection on the PPS register. In addition:

1. arrangements in place prior to registration commencement time may enjoy temporary perfection, even if not documented in writing and may be capable of maintaining continuous perfection if perfected within 24 months of registration commencement time. However, it is strongly advisable that legal advice is sought on any arrangements in existence prior to registration commencement time; and
2. arrangements entered into post-registration commencement must be documented in writing and perfected by registration on the PPS register. As noted above, the PPS Act contains strict timelines for registration on the PPS Register, which must be complied with.

Given the complexity of these provisions, all businesses should review their asset protection structures and strategies to ensure they can withstand the commencement of the PPS Act. This will include ensuring all existing arrangements qualify for temporary perfection under the transitional provisions (and are subsequently perfected within 24 months to maintain continuous perfection). Advisers should note that any ongoing asset protection advice to clients should properly consider the impact of the PPS Act.

The practicality of PPSA Legislation Tested

It should be noted for any goods supplied prior to the PPSA commencing, the creditor has a two-year transitional period in which to register their charge.

For goods supplied after the commencement of the PPSA, the creditor must register their security interest before the goods are delivered to the customer. If the registration is not completed, the charge is then technically invalid. In the case of a liquidator being appointed, goods supplied after the start of the PPSA become company assets regardless of ROT clauses if no charge is registered. There is no protection for suppliers if the registration does not occur prior to the delivery of goods to the customer.

PPSR REGISTRATION – MORE FALLOUT FROM DEFECTS

Recently we have observed a fundamental shift in protection, and the fallouts of ineffective registration are still making waves, particularly in the event of an insolvency of the grantor.

We note the PPSA, and its accompanying Personal Property Securities Register (PPSR) has increased the search fees, but the attention to detail that now must be applied by parties seeking to secure their interest has also increased maturity.

Recently, leading insolvency firm Worrells, when doing a liquidation, conducted a PPSR search for a motor vehicle and found an error in the VIN number used to identify the vehicle. In this instance, someone misplaced an "H" with an "X" in the VIN number. The ramifications of this simple mistake were severe.

In summary:

- Collateral must be described by serial number (Section 153(1) of the PPSA).
- There is a defect in the registration if collateral must be described by serial number and the search of the serial number is unable to identify the registration (section 165(a) of the PPSA).
- Motor vehicles must be described by serial number (Paragraph 2.2 of Schedule 1 of the Regulations).
- A serial number includes the VIN, the chassis number or the manufacturer's number (Paragraph 2.2(3) of Schedule 1 of the Regulations).
- Registration is ineffective if there is a defect according to Section 165 (Section 164(1)(b) of the PPSA).
- The vehicle vests in the grantor immediately before a resolution for the winding up of a company if the security interest is unperfected (Section 267(2) of the PPSA).

Given a misplaced "X" instead of an "H" in the VIN registration, the vehicle registration was unperfected and, therefore, ineffective. Under section 267 of the PPSA, the vehicle vests in the liquidator. The liquidators sold the vehicle free of any security interest and kept the proceeds of just over $32,500.

A simple typo cost the finance company dearly.

So, take care with all registrations, particularly those that require an exact match to an easily identifiable serial number like a vehicle VIN.

TIP: CONTRACTORS AND THE PERSONAL PROPERTY SECURITIES ACT 2009

Construction contractors need to be aware that registering Personal Property Security Interests ("PPSI") is not only beneficial for plant hire companies but could also benefit them.

PPSI registrations can help construction contractors in the event of their principal's insolvency by:

- Enabling suppliers of materials that have not yet been incorporated into building works to take back those materials if they have not been paid for; and
- Enabling suppliers of building materials and copyrighted plans and drawings to be paid for those supplies is prioritised over the principal's other creditors.

But PPSI registration will only have this effect if it is done on time and correctly. This requires a practical understanding of the PPSA Act and effective internal systems and procedures.

Seek expert advice before doing this.

BUSINESS SUCCESSION

The structure adopted by business owners will often be in a compromise between the immediate requirements of the business on inception, those requirements in the midlife of the business (together with competing asset protection, flexibility, and tax efficiency outcomes), and the ultimate exit option to be pursued by the business owner. Seldom is there one structure that can always fulfil all these roles in a tax-effective way.

For this reason, analysis of your business structures should be undertaken regularly and, at a minimum, whenever the business is about to undergo a significant event.

WILLS AND SUCCESSION PLANNING

The following fundamentals apply.

Wills

Depending upon the approach taken when structuring assets, it may well be there is very little to be dealt with under the will of an individual.

This may be the desired outcome if you are concerned about a disgruntled relative bringing a claim against the estate. The issue, as always, is finding an appropriate person to hold assets.

Where a couple has structured their assets in such a way that one party, who has a low-risk profile, is the 'asset holder', it is essential to ensure that their will is drafted in such a way that the good prior planning is not undone if the 'low risk' partner dies before the partner who has a high-risk profile. Rather than having assets pass to the partner with exposure, consider transferring the assets to a discretionary trust or retaining the assets in a testamentary discretionary trust, where in either case, the surviving partner is a beneficiary.

The issue of control, always an issue in the estate planning context, will again be raised. The death of the spouse whom the surviving partner had confidence in, to 'do the right thing', may make the question of who should control the assets more difficult. It may not be appropriate that control in this instance passes to the children. However, there may be similar asset protection issues in terms of the children's own exposure. They may not be willing to take on the role, or the surviving partner may not have confidence in the children acting in their best interests.

Enduring Power of Attorney

Having in place enduring powers of attorney is vitally important. The issue is not so much for the 'high risk' individual – presumably, they have taken steps to minimise their level of asset-holding. The real issue is for the party that has control of assets. Consider a wife holding the matrimonial assets wholly in her own name. Suppose she becomes incapacitated and has not appointed an enduring power of attorney with powers to make gifts and allow the husband to occupy the family home. In that case, there is a real prospect of the Public Trustee being called upon to administer the wife's affairs, and they may not have regard to the husband's needs when making decisions. This could give rise to unintended outcomes that are not favourable to either party.

Expectancies

Usually, the more important considerations in making wills are not the 'high risk' person's will but the other party who holds the valuable assets.

The 'high risk' person will generally not welcome the fact that they have an individual expectancy under another person's will – typically their spouse or parents. Their estate planning exercise might be rendered ineffective if a person holding assets dies when a claim is pending against another person who is the estate's beneficiary.

Again, consider whether assets should be transferred to a discretionary trust or retained in a testamentary discretionary trust established under the will where the at-risk party is merely a beneficiary of that trust.

Insurance

Similar considerations arise when nominating beneficiaries under insurance policies, whether they flow from life and TPD cover (if not already in a superannuation fund) as well as other insurances, such as income protection insurance.

Control of entities

Although a person may no longer be an asset holder, they may still hold some level of control over entities. Examples include shareholdings in corporate trustees, direct trusteeships or powers of appointment contained in a trust deed.

Control via shareholdings can usually be dealt with efficiently by diverting the shares.

Where the individual acts as a trustee, refer to the trust deed. The deed may allow the individual trustee to appoint a successor under their will.

In cases where the individual has a power of appointment under a trust deed to appoint and remove the trustees or beneficiaries (or both) – usually, that person is called the Appointer, Principal or Guardian of the trust. You should refer to the deed to establish whether a successor can be appointed under the Appointer's will.

TESTAMENTARY TRUSTS AND ASSET PROTECTION

We have already discussed the importance of nominating a "high risk" spouse for asset protection purposes, but what happens when a "low risk" spouse dies suddenly?

Essentially a Testamentary Trust (TT) is a trust created by the express terms and conditions of a valid will. Some

TTs are fixed trusts (e.g., $50,000 to be held on trust for Tom until he reaches 25 years), while others have the features of a normal discretionary trust.

TTs are able to protect a testator's assets for future generations. Rather than bequeath assets directly to a beneficiary, a TT may be created to hold assets for the benefit of a beneficiary to provide Asset Protection:

- Against the spouse of a beneficiary in the event of separation and marital breakdown.
- For the beneficiary of a deceased estate at risk from creditors' claims.
- For vulnerable beneficiaries, i.e., those with substance abuse issues or gambling problems.

Always ensure the TT is appropriately drafted, allowing it to be effective – this means seeking advice from a competent legal practitioner.

Peter is a Chartered Accountant, and from an asset protection perspective, is the high-risk spouse. He is married to Clare, the low-risk spouse – accordingly, the family home and investment portfolio have been acquired in her name.

Peter and Clare have not undertaken any estate planning and have only prepared basic DIY wills.

If Clare were to die suddenly, the assets held in her name would transfer to Peter pursuant to her will. Consequently, these assets could be at risk as Peter, a high-risk person, now holds them. If Peter decides to transfer the assets out of his name, there will be likely adverse CGT and stamp duty implications for such a transfer, with the bankruptcy clawback rules also a potential issue.

The above situation is avoided if Clare's will directs that the family home and investment portfolio are held in a testamentary trust for a range of beneficiaries, including Peter and their family. So, these assets would be legally owned by the trustee of the TT, with Peter and other family members receiving distributions of capital and income from the TT.

MANAGING THE RISK OF CLAIMS AGAINST YOUR ESTATE – ASSET PROTECTION POST MORTEM

You must have an open discussion with your lawyer on minimising the risk of challenges to your estate as estate litigation is becoming increasingly prevalent in Australia.

Leaving an estranged child a 'nominal amount' in their will does not necessarily mean the child cannot challenge their will.

Nor does leaving your estate equally to your children means children cannot challenge their will.

In addition, many people struggle to understand why someone should be able to make a claim against an estate - particularly an estate where the deceased left a valid will. For example: "Dad made a will. How can someone challenge how he wanted to leave his estate? His will set out what he wanted, and that should be it."

As part of a comprehensive estate plan, you should carefully consider the people, in your particular circumstances, that you are obliged to make adequate provision for, who consequently will have the right to make a claim against your estate if adequate provision is not made.

POTENTIAL INHERITANCE AT RISK DURING BANKRUPTCY – FIVE REAL-LIFE EXAMPLES TOTALLING ALMOST $1 MILLION.

Here we are talking about after-acquired property in bankruptcy and, more generally, the risk to inheritances.

Leading insolvency firm Worrells published an article that warns those considering bankruptcy or advisers who have a client considering bankruptcy, where there is a chance that they or their client may receive an inheritance (otherwise known as a bequest).

The below examples relate to one small regional office of Worrell's over 12 months.

1. An uncle who never changed his Will despite the bankrupt telling him to—$259,000 recovered, and they are expecting a further $100,000.
2. A mother who did not have the capacity to change her Will—$100,000 recovered.
3. A brother who died intestate (i.e., no Will) without any children or a partner—$97,000 recovered.
4. A mother who did not know about the bankruptcy because her daughter was too scared to tell her—expecting to recover $120,000 in the next month.
5. A grandmother whose Will Worrells were not aware of—recovered $55,000 and expecting a further $170,000 in the next six months.

The concept of after-acquired property is set out in section 58 of the Bankruptcy Act 1966. It essentially provides that any assets that devolve upon a bankrupt during bankruptcy (i.e., the bankrupt becomes entitled to during bankruptcy) will vest in the bankruptcy trustee. The two best-known types of property that vests as after-acquired property are:

- Prize winnings – e.g., lotto.
- Inherences from deceased estates.

For those wanting to prevent the “family fortune” from falling into the bankruptcy trustee’s hands, the options include:

1. Amend Wills to exclude the bankrupt for, at least, the standard bankruptcy period (three years). Once the bankrupt is discharged from their bankruptcy, those Wills can be changed again to include the bankrupt receiving a benefit from the deceased estate.
2. Amend Wills to leave the assets to a discretionary testamentary trust whereby the bankrupt can be a beneficiary. Still, it’s at the trustee’s (of the testamentary trust) discretion to distribute anything to the bankrupt during the bankruptcy period.

SOLE DIRECTOR AND SHAREHOLDER BECOMES BANKRUPT

Sole director and shareholder companies have been allowed since the mid-’90s. This may well be an ideal structure for many small businesses, but what happens when the sole director becomes bankrupt?

Section 206B of the Corporations Act provides that a person is automatically disqualified from “managing a corporation” on becoming bankrupt. Further, section 201F (3) strongly suggests that “disqualified” automatically means removal from the position of director. Thus, there appears to be no need for the bankrupt to take any overt action to resign as director.

The bankrupt’s shareholding in the company will vest in the trustee of the bankrupt estate. However, the trustee does not become a shareholder in the company until the director causes the share register to be updated. This results in a company without a director and no registered shareholder who can rectify the position. It is a rudderless ship.

Often the bankrupt’s company will be liquidated or struck off by ASIC. However, on occasion, there may be a financial advantage in keeping the company alive. Fortunately, the Corporations Act has a machinery section that overcomes the no director or registered shareholder impasse.

Section 201F (3) explicitly states that a trustee of the bankrupt estate may, where the bankrupt was the sole director and shareholder, appoint a person as the director of the company. Further, subsection (4) allows the trustee to appoint themselves.

Whether the trustee should take up the appointment would depend on the circumstances, and many trustees would hesitate to take on that role if any risk were perceived.

EMPLOYEE ENTITLEMENTS

Many of us know people who have found themselves in the unenviable position of being owed statutory superannuation, wages, holding pay and long service leave by companies that have gone into liquidation or been abandoned by the Directors.

Note the below changes:

Winding up abandoned companies by ASIC

The Corporations Amendment (Phoenixing and Other Measures) Act 2012 (Cth) commenced on 1 July 2012. In summary, this Act amended the Corporations Act 2001 to provide ASIC with discretionary power to liquidate a company when specific criteria are met. This new power provides a process to wind up a company to facilitate payment of employee entitlements where a company has been abandoned.

GEERS now ‘Fair Entitlements Guarantee Scheme.’

From 5 December 2012, the Fair Entitlements Guarantee Act 2012 (Cth) commenced operation and replaced the Federal Government’s General Employee Entitlements Redundancy Scheme (GEERS) with the Fair Entitlements Guarantee (FEG) scheme.

In the main, the FEG replicates the assistance provided to employees through the previous GEERS administrative scheme. The fundamental changes under the FEG include limiting the lodgement of claims to 12 months from the end of employment or the date of insolvency, restricting access to the FEG to Australian citizens, and providing claimants with the ability to seek a review of a claim decision by the Administrative Appeals Tribunal.

WHAT ARE MY OPTIONS FOR DEALING WITH UNMANAGEABLE DEBT?

The website of the (AFSA) contains valuable information for individuals with debt issues… www.afsa.gov.au

You may have unmanageable debt and need help to work out what to do. There are people who can help you look at all your options before you make a final decision.

To ensure you make the right decision for your situation, learn about:

- people who can help and advise you
- formal options under the Bankruptcy Act 1966

- other options - some of which may be legally enforceable, others not
- a creditor making you bankrupt.

AFSA manages the bankruptcy of individuals. If you need information about an insolvent company, contact the Australian Securities Investments Commission (ASIC).

Go to https://www.afsa.gov.au/insolvency/i-cant-pay-my-debts/what-are-my-options as the page contains relevant links to address all the issues.

The advice to a friend or colleague facing these issues must be clear... address the matter immediately and seek sound advice from a specialist in the field.

All too often, we see people in business throwing more personal money into an unsustainable business... losing more than they should or even jeopardising their individual solvency.

As for personal debt, some arrangements can be made once the issue is addressed. Not resolving the issue can take a serious toll on people.

We stress the importance of doing the research yourself and being well informed as in June 2018, ASIC warned consumers about companies that claim they can fix a poor credit rating. In June 2018, ASIC ran a month-long campaign with other Commonwealth, state, and territory agencies to help consumers understand that they may end up paying high fees by using credit repair and debt management firms.

Consumers should be aware that these companies often fail to fix credit and debt issues, leaving people in a worse financial situation.

People experiencing debt problems can seek free help and guidance from financial counsellors and the National Debt Helpline on 1800 007 007 or go to ndh.org.au.

Comprehensive reform of the debt agreement system

In 2018, the Federal Parliament passed legislation to reform debt agreements to help more people avoid personal bankruptcy and provide greater protection for debtors and creditors.

The Bankruptcy Legislation Amendment (Debt Agreement Reform) Bill 2018 is the first comprehensive overhaul of Australia's debt agreement system in a decade.

Debt agreements are an important and popular alternative to bankruptcy for individuals who are facing financial difficulties.

The number of new debt agreements has almost doubled in the last decade, while bankruptcies have significantly reduced.

Debt agreements give people time to clear their debts and get back on their financial feet while avoiding the formal bankruptcy process and its potential longer-term impact on their financial circumstances.

These reforms ensure debt agreements are based on an affordable payment schedule by linking repayments to a certain percentage of income. The percentage will be determined in consultation with key industry bodies, consumer groups and creditor representatives.

Other key measures include:

- Limiting the length of a debt agreement proposal to three years, allowing debtors to manage their debts in the short term and work towards a fresh start while maintaining flexibility to allow extensions if debts remain unpaid.
- Doubling the current asset eligibility threshold (now $238,238) in recognition of the growing value of Australia's property market, opening the debt agreement option to more people who are facing financial difficulty.
- Providing the Official Receiver in Bankruptcy the ability to reject proposed debt agreements which would cause undue financial hardship to the debtor.
- Deterring unscrupulous practices by a small minority of debt agreement administrators by setting stricter practice standards; stricter penalties for wrongdoing (such as a new three-month period of imprisonment if an administrator offers a creditor money intending to influence their vote) and granting the Inspector-General in Bankruptcy additional investigative powers to address misconduct.
- Ensuring greater professionalism in the industry by requiring debt agreement administrators to hold and maintain professional indemnity and fidelity insurance as a requirement of registration.

Currently, unregistered administrators will have a year register as an administrator or trustee if they wish to continue administering debt agreements.

These reforms commenced on 27.6.2019 after giving the debt agreement industry time to prepare for the reforms.

This legislation makes the debt agreement system fairer and more efficient for debtors and creditors alike and will protect people who are in a vulnerable financial position from financial exploitation.

INSOLVENCY CHECKLIST

A solvent person is defined in Section 95A of the Corporations Act and Section 5(2) of the Bankruptcy Act as being one that is able to pay all the person's debts as and when they become due and payable.

These definitions support the proposition that solvency is determined by reference to cash flow. In addition, there are critical operational and financial practices that may put a company at risk of becoming insolvent.

Set out below is our Insolvency Checklist. If you answer "Yes" to one or more of the following questions, then your business may be insolvent or at risk of becoming insolvent at some time in the future.

1.	Are creditors being paid outside their normal terms of trade (e.g., 30 days)?	☐ Yes ☐ No
2.	Has the entity conducting the business received final demands for payment from creditors?	☐ Yes ☐ No
3.	Has the entity received: - Letters from collection agencies/solicitors for payment of debts. - Statutory Demands for payment?	☐ Yes ☐ No
4.	Has the entity been placed on COD terms with essential suppliers?	☐ Yes ☐ No
5.	Does the entity pay one supplier in priority to another to receive goods/services?	☐ Yes ☐ No
6.	Have any of the BAS/IAS of the entity been lodged significantly later than the due date and, or are there any outstanding BAS/IAS?	☐ Yes ☐ No
7.	Are there any outstanding statutory liabilities of the entity, Including PAYG/GST. - Compulsory superannuation. - Workers Compensation. - Payroll Tax?	☐ Yes ☐ No
8.	Has the entity entered into an instalment payment plan with any of its creditors and, or the ATO?	☐ Yes ☐ No
9.	Has the entity made any payments to creditors for round lump sum amounts, which are not reconcilable to specific invoices?	☐ Yes ☐ No
10.	Has the entity withheld cheques until monies become available and, or issued post-dated cheques to creditors?	☐ Yes ☐ No
11.	Have any cheques and, or payments of the entity been dishonoured?	☐ Yes ☐ No
12.	Is the overdraft (if applicable) of the entity steadily increasing or at its maximum limit?	☐ Yes ☐ No
13.	Is the entity unable to raise further finance and or sell surplus assets?	☐ Yes ☐ No
14.	Are you unable to inject additional capital into the entity?	☐ Yes ☐ No
15.	Are the current liabilities of the entity in excess of its current assets?	☐ Yes ☐ No
16.	Are total liabilities of the entity in excess of its total assets?	☐ Yes ☐ No
17.	Does the entity have accumulated trading losses?	☐ Yes ☐ No
18.	Has the entity failed to prepare timely financial information to allow management to review its trading performance and financial position?	☐ Yes ☐ No
19.	Has the entity or its accountant failed to prepare a set of annual financial statements and a tax return in the past 12 months?	☐ Yes ☐ No
20.	Has the entity failed to prepare budgets and corporate plans?	☐ Yes ☐ No

If you have answered yes to any of the above questions, you should carefully consider your position and consider seeking professional advice.

DISCLAIMER

The information statement and opinions expressed in this publication are only intended as a guide to some of the important considerations to be taken into account relating to taxation matters. Although we believe that the statements are correct, and every effort has been made to ensure that they are correct, they should not be taken to represent taxation advice and you must obtain your own independent taxation advice. Neither the authors, nor the publisher or any people involved in the preparation of this publication give any guarantees about its contents or accept any liability for any loss, damage or other consequences which may arise as a result of any person acting on or using the information and opinions contained in this publication.

Readers seeking taxation advice should obtain their own independent advice and make their own enquiries about the correctness of the information set out in this publication and its accuracy in relation to their own particular circumstances.

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