bO2 Corporate Essentials

Tax Smart Australia

Issue
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Tax Essentials - Asset Protection

AUGUST	2018

THE NEWSLETTER

Tax Update – Impact on Small Business

LEIGH'S CORNER

Sickness In The Workplace

Article No. 42

SPECIAL BONUS ISSUE

Asset Protection 2018 (Safeguarding Your Future)

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Contents

THE NEWSLETTER

And once again we're highlighting an old favourite.... "The Client and the Adviser" given recent events it remains pertinent and is well worth a read.

The Newsletter

Editor's note

So out there at the coal face, what is going on?

Part of the pub or barbeque tack is some bright spark telling others they can claim up to 5,000 business kilometres without substantiation or logbooks, this equates to a tax deduction of $3,300. This is not quite the case allowing for annual leave and public holidays. An annual claim of 5,000 business kilometres works out at 110 business kilometres a week. In the event of an ATO audit you will need to plausibly demonstrate how your motor vehicle was used on tax deductible work-related journeys up to the number of kilometres claimed. Your employer may well be contacted for verification and your status in the work place will not be enhanced in the event you have made false or misleading representations to the ATO.

SUPERANNUATION

If the contributions caps are indexed, why aren't they increasing for the 2018/2019 year?

Many have asked us this question...

The annual $25,000 concessional contributions cap is indexed, in $2,500 increments, rounded down to the nearest multiple of $2,500. Indexation is in line with the annual increase in full-time average weekly ordinary time earnings (AWOTE).

The annual $100,000 non-concessional contributions cap is indexed in $10,000 increments, in line with the indexation of the concessional (before-tax) contributions cap.

Since wages growth has been minimal, and wages would need to grow 10% for the concessional contributions cap to increase to $27,500, as confirmed by the ATO, Australians are still subject to a $25,000 concessional cap, and hence still subject to the $100,000 non-concessional cap, for the 2018/2019 financial year.

Wages growth has been static in Australia, and indexation for the contributions is based on the previous calendar year's movements in AWOTE (June 2017, and December 2017 movements). So, AWOTE has only increased 2.36%, which means if this level of wages growth continues, we will have a $25,000 concessional cap for at least 3 more years. We note the recent 3.5% increase in the minimum weekly wage.

KEY CHANGES REGARDING GROUP CERTIFICATES

In the first two weeks of July millions of Australian employees eagerly anticipated the receipt of their annual group certificates (payment summaries) – many unaware that are receiving this documentation for the last time.

With single touch payroll, group certificates are being phased out in 2018 – 19 for entities with more than 20 employees. When all small employers come on board in 2020 very few employees will be receiving group certificates.

At the digital era gathers force and the ATO moves ever increasingly toward online tax returns with pre-filling of tax data, the future for the vast majority of taxpayers looks paperless.

This of course also has major implications for the tax profession. This trend is inexorable with 11 O.E.C.D. nations having finalised online tax returns for most taxpayers. In New Zealand only around 45% of employed taxpayers choose to prepare a tax return. The essence of single tax payroll is that businesses disclose any tax deducted from staff salaries in real time – thus negating any need for group certificates. This enables the ATO to more effectively keep tabs on employers' compliance with their tax obligations.

We have covered in our last issue the crack down on Work Related Expenses (WRE) our last issue, in the 2018 Federal budget the government allocated an additional $139 million to achieve this end.

If this does not have the desired effect in raising additional revenue, we see the introduction of a set standard tax deduction for WRE as inevitable.

This has certainly worked overseas and was first raised in the 2010 Henry tax review. Certainly, treasury favours this option. The implications for tax accountants are not all negative – they will have more time to value add for their business clients taking the opportunity to give them timely business advice.

Henry Tax Review

Certainly, Treasury favours this option. The implication for tax accountants are not all negative – they will have more time to value add for their business clients taking the opportunity to give them timely business advice.

TAX CHANGES FOR FOREIGN INVESTORS

On 17.5.2018 the Government released exposure draft legislation and explanatory material for public consultation on the tax treatment of stapled structures to give effect to the policy announced on 27 March 2018.

This puts into action targeted integrity rules designed to neutralise the tax benefits of stapled structures.

An increasing number of foreign investors have sought to convert trading income into more favourably taxed passive income through the use of stapled structures. When combined with existing concessions used by foreign pension funds and sovereign wealth funds, some foreign investors are currently paying tax rates of 15 per cent, or in some cases, far less.

The proposed amendments in the announced package will ensure that:

- trading income that is converted to passive income will be taxed at the corporate tax rate;
- foreign investors will no longer be able to use multiple layers of flow-through entities (i.e. trusts and partnerships) to 'double gear' their investments to generate more favourably taxed interest income;
- foreign pension fund withholding tax exemption for interest and dividends is limited to portfolio investments only;
- a legislative framework is created for the existing tax exemption for foreign governments (including sovereign wealth funds), and limit the exemption to passive income from portfolio investments; and
- investment in agricultural land will not be able to access the 15 per cent concessional MIT withholding tax rate. New Government-approved nationally significant infrastructure assets may be eligible to access the 15 per cent concessional withholding tax rate for managed investment trusts for 15 years. This will ensure continued support for the development of nationally significant infrastructure assets that enhance the productive capacity of the economy and drive long term economic growth.

To minimise the impact of these changes on existing investments, the proposed amendments include transitional arrangements of seven years (for ordinary business staples) and 15 years (for economic infrastructure assets).

The stapled structures package is an important integrity measure, and the Turnbull Government is committed to introducing legislation as soon as possible. To maximise time for consultation, draft legislation will be released in stages.

The released exposure draft legislation contains the first four proposed amendments in the package. Draft legislation on the agricultural MIT changes and the conditions stapled entities must comply with to access the infrastructure concession and/or transitional arrangements will be released in due course.

ATO PRACTICE STATEMENT + PS LA 2008/6 AS RECENTLY UPDATED

The Law Administration Practice Statement provides guidance to ATO staff involved in matters where there has been, or is suspected to have been, fraud or evasion.

This practice statement provides guidance to ATO staff considering fraud or evasion in the context of the unlimited time periods which allow the Commissioner to amend assessments (or to seek the payment of indirect tax which has been underpaid) due to fraud or evasion.

Fraud and evasion are two separate and distinct concepts.

Fraud - For the purposes of this practice statement, 'fraud' may be described as making false statements knowingly or without belief in their truth (including such as when made recklessly, careless as to whether it is true or false), to deceive the Commissioner.

Evasion - The threshold for an opinion of evasion is not as high as fraud. A taxpayer's behaviour may not constitute fraud but be nevertheless sufficiently blameworthy to constitute evasion.

'Evasion' is best explained by reference to the judgment of Dixon J in Denver Chemical Manufacturing v. Commissioner of Taxation (Denver) in which his Honour noted it would be unwise to attempt to define the word 'evasion' but nevertheless suggested a 'blameworthy act or omission on the part of the taxpayer' was contemplated.

The High Court's guidance from Denver as to what constitutes evasion, including the notion that some blameworthy act or omission is contemplated, has been applied by the Federal Court and State Supreme Courts ever since. Refer to Appendix 1 of the Fraud or evasion guideline (period of review) for an overview of how evasion has been considered by the High Court.

An opinion of evasion is a serious matter. It requires culpable conduct of the taxpayer, as described further below.

What is a 'blameworthy act or omission'?

The notion of a 'blameworthy act or omission':

- lies somewhere between innocent mistake and intention to defraud
- usually involves (in a taxation context) making a wrong statement or taking an incorrect position without a credible explanation
- involves culpable conduct; being something more than mere avoidance or the mere withholding of information or supplying misleading information; such as an intention to withhold information from the Commissioner on the basis the Commissioner would likely take a different view of the tax outcome if the relevant act or omission (for example omission to disclose information) had not occurred and instead accurate representations or disclosures had been made.

The material facts must be examined to assess whether the relevant conduct is 'blameworthy'.

Evasion is to be assessed objectively, based on the standard of a reasonable person in the position of the taxpayer. In other words, evasion involves conduct that a reasonable person seeking to comply with their tax obligations would not engage in.

When does evasion arise in a self-assessment environment?

The leading High Court authorities for the meaning of evasion relate back to periods before the introduction of self-assessment into the tax system. So, although the meaning of evasion has not changed, the circumstances in which it arises have changed in some cases.

Under self-assessment, taxpayers are not usually required to include detailed information in their tax returns. Consequently, evasion involving deliberate withholding of information does not usually occur at the return stage. Rather, such withholding of information might occur through a wilful or reckless failure to keep records or to supply information during the course of a tax audit. It may also occur in relation to a failure to provide information required by the Commissioner in a fuller return or schedule.

However, simpler instances of evasion will arise at the return stage; for example, where income is intentionally omitted from a tax return with no credible explanation.

The policy of Australian taxation law is generally to provide certainty and finality after a specified period, both for the taxpayer and for the Commissioner, regarding the tax liability of the taxpayer for a year of income or an accounting period.

For instance, the statutory time limits that apply for amending income tax assessments (two years or four years) emphasise our duty to make timely enquiries and appropriate assessments.

The time limits for amending assessments under a self-assessment system are premised on the good conduct of the taxpayer, tax agents, and others concerned with the assessment.

Fraud and evasion, however, involve culpable misconduct. The exceptions to the statutory time limits that apply where the Commissioner is of opinion that there has been fraud or evasion make clear that a taxpayer is not entitled to the benefit of a time limit for an amended assessment if the previous assessment is less than it ought to be (or where refunds or credits have been over-claimed) because of dishonesty or other blameworthy conduct.

PS LA 2008/6 goes on to emphasise that only senior ATO staff make these decisions in conjunction with ATO policies and practices bearing in mind the weight parliament has placed on certainty and fairness for taxpayers.

ADVISORY BOARD TO HELP CLAMP DOWN ON THE BLACK ECONOMY

The Turnbull Government has established a new Advisory Board to support its reform agenda to disrupt the black economy.

Michael Andrew AO, who provided strong leadership to the Black Economy Taskforce in 2017, will chair the Black Economy Advisory Board.

The Advisory Board will include members of the private and public sector who will provide strategic advice on trends and risks in the black economy.

The Advisory Board will also advise the Treasury about implementation of the Government's decisions attacking the black economy and contribute to a Government report every five years about new threats emerging in the black economy.

According to Kelly O'Dwyer the Minister for revenue and financial services:

- The black economy is a serious problem that does harm to the community and honest businesses and deprives the community of revenue needed to support vital community services.
- Honest businesses meeting their tax and other obligations lose out to competitors doing the wrong thing and induce others to begin operating in the black economy in order to remain competitive.
- The Government's actions include a $10,000 limit on cash transactions, a comprehensive strategy to combat illicit tobacco, reforms to the Australian Business Number system, restricting government procurement to businesses that have acceptable tax records, and $315 million in additional funding to the ATO to increase its enforcement activity against black economy behaviour.
- A new black economy standing taskforce, led by the ATO, will also ensure a whole of government approach with agencies sharing intelligence and best practice.

The final report of the Black Economy Taskforce, the Government's response and current consultation are available on the Treasury website.

IMPROVING THE ATTRIBUTION MANAGED INVESTMENT TRUST REGIME

The Federal Government is continuing with important reforms to improve Australia's taxation regime for the managed funds industry and this committed to setting an appropriate legislative framework for what is the largest managed funds industry in the South Pacific.

On 18.6.2018, draft legislation and explanatory material for public consultation was released on a package of technical amendments to ensure the new system for attribution managed investment trusts (MITs) operates as intended. The amendments give effect to my announcement of 19 July 2017.

The amendments will clarify the law, providing industry with increased investment certainty and should assist those entities considering whether to opt into the attribution MITs regime.

The attribution tax regime was designed to give greater certainty to investors in managed funds, reduce compliance costs for the funds and enhance overall the competitiveness of Australia's funds management industry.

NEW LAWS WILL PROTECT YOUR SUPERANNUATION SAVINGS

The Turnbull Government has taken action to protect the hard-earned superannuation savings of millions of Australians from rorts and rip-offs.

The Treasury Laws Amendment (Protecting Your Superannuation Savings Package) Bill 2018 introduced into Parliament on 21.6.2018 includes a range of reforms which will protect against the undue erosion of superannuation balances through excessive fees and inappropriate insurance arrangements.

The reforms will also, for the first time, provide the ATO with the ability to proactively reunite Australians with their low balance, inactive accounts.

Fee protections

The Bill prevents trustees of superannuation funds from charging administration and investment fees exceeding 3 per cent per year, of the balance of accounts below $6,000.

The Government's changes also prevent trustees from charging exit fees when members close or rollover their superannuation accounts, no matter their balance.

These changes will help to prevent erosion of low balance accounts by high passively-incurred fees and will remove a disincentive to superannuation fund members consolidating and closing unwanted accounts.

Tailoring insurance arrangements in superannuation

Under this Bill, fund trustees are required to provide insurance on an opt in basis only to new members aged under 25 years, members with account balances below $6,000, and members with inactive accounts, unless a member has directed otherwise.

This will better target default insurance cover and prevent inappropriate erosion of retirement savings by insurance premiums for cover members do not know they have, that goes beyond what they need, or which they cannot even claim on.

Importantly, members will still be able to obtain insurance cover within their superannuation if they choose to do so – young, inactive and low balance account holders will still be able to opt in to insurance through superannuation.

These measures address significant issues associated with the current default insurance arrangements in superannuation.

Reuniting your super

The Bill will also further protect accounts below $6,000 from fees and charges by requiring them to be transferred to the Commissioner of Taxation if they have been inactive for a continuous period of 13 months.

The Government will empower the Commissioner to then proactively pay these amounts, plus those lost accounts already held by the ATO, into the rightful owner's active superannuation account.

This will increase the rate of account consolidation across the superannuation industry, reduce the number of inactive low balance accounts at risk of erosion and reduce insurance premium and fee duplication for many members.

It adds to earlier legislation introduced into the Parliament to improve fund governance, transparency and accountability to members, and to provide greater powers to the regulator to better protect members and their money.

After all, your superannuation is your money.

HARDING V COMMISSIONER OF TAXATION [2018] – EXPAT RESIDENT OF AUSTRALIA

This case looks deal with a taxpayer who was an expat in the Middle East. The Federal Court found that although the taxpayer was not a resident of Australian according to ordinary concepts, he was found to be an Australian resident as the taxpayer conceded he had retained his Australian domicile in the relevant year and had no permanent place of abode. He had stayed in the same apartment tower in Bahrain but did not stay in the same fully furnished apartment.

The Court found in the relevant income year Mr Harding did not establish a permanent place of abode in Bahrain. By its character it was a type of premises used for temporary or transitory accommodation and Mr Harding used it as such. By Mr Harding's own acknowledgements in his affidavit, his presence in that accommodation in that years was temporary and only intended to continue until he was joined by his wife and youngest son at which time they would have acquired permanent accommodation.

So, what is the takeout here?

If, at all possible, make the characteristics of any tenancy permanent – one set dwelling as soon as you leave Australia. It is acknowledged that this will not always be possible due to contractual constraints.

TAXATION RULING

TR 2018/5

Income tax: Central management and control test of residency

This Ruling sets out the Commissioner's view on how to apply the central management and control test of company residency1 following Bywater Investments Limited & Ors v. Commissioner of Taxation; Hua Wang Bank Berhad v. Commissioner of Taxation [2016] HCA 45; 2016 ATC 20-589 (Bywater).

A company is a resident or a resident of Australia under the central management and control test of residency if it:

- carries on business in Australia, and
- has its central management and control in Australia?

Four matters are relevant in determining whether a company meets these criteria:

(1) Does the company carry on business in Australia? (see paragraph 6 of this Ruling).

(2) What does central management and control mean? (see paragraph 10 of this Ruling).

(3) Who exercises central management and control? (see paragraph 19 of this Ruling).

(4) Where is central management and control exercised? (see paragraph 30 of this Ruling).

Whether a company is a resident under the central management and control test of residency must be determined by reference to all the facts and relevant case law.

Does a company carry on business in Australia?

To be resident under the central management and control test of residency, a company must carry on business in Australia.

If a company carries on business and has its central management and control in Australia, it will carry on business in Australia within the meaning of the central management and control test of residency.

It is not necessary for any part of the actual trading or investment operations of the business of the company to take place in Australia. This is because the central management and control of a business is factually part of carrying on that business. A company carrying on business does so both where its trading and investment activities take place, and where the central management and control of those activities occurs.

Central management and control of a company is not necessarily exercised where the trading or investment activities of the company are carried on

What does central management and control mean?

Central management and control refers to the control and direction of a company's operations. It does not refer to a physical location in which the control and direction of a company is located and may ultimately be exercised in more than one location.

The key element in the control and direction of a company's operations is the making of high-level decisions that set the company's general policies and determine the direction of its operations and the type of transactions it will enter.

So, we see that having overseas staff, offices and bank accounts simply does not stop an entity being deemed a resident Australia company

APPLYING GST TO LOW VALUE IMPORTED GOODS

From 1 July 2018, businesses that sell goods into Australia and meet the goods and services (GST) registration threshold of A$75,000 will need to register and pay GST on goods that are:

- less than A$1,000
- imported into Australia
- not GST-free items (for example, items of food).

This change also means Australian-based retailers that drop-ship goods will need to charge GST from 1 July 2018.

Those who buy low value imported goods should not be charged GST if they:

- are registered for GST
- import the low value goods for business use in Australia
- provide their Australian business number (ABN) to the supplier, along with a statement declaring they are registered for GST.

In the event you are incorrectly charged GST, you should initially seek a refund from the supplier. In some situations, you may be entitled to claim a GST credit instead.

It is essential that when claiming a GST credit, that you have a valid tax invoice. Only receipts which contain an ABN are valid tax invoices - even if they apply GST. Some overseas suppliers may be registered in the simplified GST system and have an Australian Taxation Office reference number (ARN) instead of an ABN.

REGISTERED CHARITIES NOT REQUIRED TO PAY ASIC LEVY

The Federal Government maintains it is committed to improving consumer outcomes in the financial services sector. The ASIC industry funding model is an important element in the delivery of this commitment.

Under the ASIC industry funding model, the costs of regulation are borne by those that have created the need for it through the payment of levies, rather than the Australian public. Industry funding, increases transparency, makes industry more accountable for its behaviour and makes ASIC a stronger regulator.

However, recognising the unique and important role charities play in our society, the Government will absorb ASIC's costs of regulating the charities sector. This means that registered charities will not have to pay ASIC levies.

Because of this decision, over 8,000 incorporated registered charities can now direct the fees they would have had to pay to ASIC towards charitable purposes.

The Government appreciates industry's engagement throughout the development of the industry funding model and its associated Regulations.

This change forms part of a broader set of amendments to the Regulations underpinning the ASIC industry funding model. Further details on these Regulations and the industry funding model can be found on ASIC's website.

ENSURING FOREIGN INVESTORS PAY AUSTRALIAN TAX - INTEGRITY MEASURES PAPER RELEASED ON STAPLED STRUCTURES

In March, The Federal government announced a package of measures to reform the tax treatment of stapled structures and similar arrangements.

The package ensures trading income for foreign investors is taxed at the corporate tax rate, and limits access to broader concessions for passive income utilised by foreign governments and foreign pension funds.

On 28.6.2018, a paper for public consultation was released outlining the conditions stapled entities must comply with to access the proposed infrastructure concession and transitional arrangements.

These conditions were flagged in the Government's announcement earlier this year addressing the tax integrity risks posed by stapled structures and provides a further safeguard against aggressive cross staple pricing arrangements during these transition and concession periods.

The conditions include:

- The extension of existing integrity rules that apply to Managed Investment Trusts (MITs) to ensure that all staples are required to set their rent at market prices; and
- The introduction of statutory caps on the amount of cross-staple rent that can access the concessional rate of withholding tax (available under the MIT regime) for new and existing infrastructure projects during the transition or concession period.

Treasury is currently preparing exposure draft legislation on the proposed rules outlined in the paper.

BETTER TARGETING THE RESEARCH AND DEVELOPMENT TAX INCENTIVE

The proposed amendments to the R&DTI form the Government's response to the recommendations of the 2016 *Review of the R&D Tax Incentive and the Innovation and Science Australia 2030 Strategic Plan*.

The Turnbull Government is seeking stakeholder feedback on the implementation of the proposed amendments. The exposure draft legislation, explanatory materials and consultation document are available on the Treasury website. Interested stakeholders are encouraged to provide their views by Thursday 26 July 2018.

STARTING OR GROWING A BUSINESS STARTS HERE

On 29.6.2018 the Federal Government officially launched the Business Registration Service providing a simpler and clearer way to register a business.

"Every year thousands of new businesses start-up around Australia, and to speed them through this process the Turnbull Government is making it possible to get multiple business and tax registrations online through our new stand-alone Business Registration Service," the Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP said.

"The service will be more efficient for businesses, and they will avoid applying for registrations they don't need."

"The Business Registration Service is an integral part of the Government's National Business Simplification Initiative," Minister O'Dwyer said.

Over 140,000 registrations have been submitted since the trial version of the service was released in April 2017. The Business Registration Service has reduced the average time taken to obtain a business and associated licences to under 15 minutes.

"The response from users has been overwhelmingly positive and we've used it to continue making the service even better," the Minister for Small and Family Business, the Workplace and Deregulation, the Hon Craig Laundy MP said.

"So far, we have made improvements to the payments screens, added links to Australian Business Licence and Information Service for state and local government registrations and licences; and started sending notification emails to direct users back to the dashboard for status of their registrations."

The Government has achieved its goal of creating competition in the registration services market. The Application Programming Interfaces (APIs) that support the registration service were made public in February 2017 for use via approved third-party registration services.

The Department of Industry, Innovation and Science, the Australian Taxation Office, the Australian Securities and Investments Commission, and the Department of the Treasury collaborated to develop the service available at business.gov.au.

GARNISHEE NOTICE

The ATO's current approach to a routine debt collection practice has recently under immense media scrutiny.

The ATO has the power to recover debt through third parties of an entity that owes money to them. The mechanism used to enforce this right is known as a "garnishee notice". There were allegations that staff at the ATO were told "to start issuing standard garnishee notices on every case". The ATO vigorously denied this position in a statement; saying that "it only issued 14,000 garnishee notices for small businesses in the past financial year, accounting for 0.5% of 'collectable debt cases'."

The Minister for Revenue and Financial Services, Kelly O'Dwyer, is looking into these matters first raised by Four Corners and Fairfax media.

We outline how ATO garnishee notices work in practice.

Legislation

Section 260-5 in schedule 1 of the Taxation Administration Act 1953 (TAA) provides the ATO with the power to recover tax related liabilities and certain other debts payable to the Commonwealth from third parties owing money to, or holding money for, a tax debtor. The Commissioner's practice statement PSLA 2011/18 at paragraph 98 states:

"Where a person (third party) owes money to or holds money for a tax debtor, section 260-5 of Schedule 1 to the TAA empowers the Commissioner to require the third party to pay that money to the Commissioner rather than paying it to, or continuing to hold it for, the tax debtor. This power is commonly referred to as a 'garnishee power' and a written notice issued by the Commissioner under subsection 260-5(2) of Schedule 1 to the TAA is referred to as a 'garnishee notice'."

The Commissioner goes on to state at paragraph 118:

"A garnishee notice in respect of any tax-related liabilities may be served on a superannuation fund but it will not be effective until the tax debtor's (member's) benefits are payable under the rules of the fund (for example, the tax debtor retires or dies). A notice served on the fund will generally request payment as a lump sum unless the anticipated retirement income stream can guarantee repayment within a satisfactory period of time."

AUSTRALIAN SENATE ECONOMICS COMMITTEE HANDS DOWN REPORT ON CORPORATE TAX AVOIDANCE

The Commonwealth Senate Economics Committee recently handed down its long-awaited final report on corporate tax avoidance in Australia.

This is the culmination of the Committee's three-and-a-half-year investigation on corporate tax avoidance, following the matter's referral to the Committee on 2.10.2014. there were two previous interim reports published by the Committee in 2015 and 2016.

Some of the key recommendations of the final report include that:

1. companies with annual turnover of $100 million or more be required to publicly report certain tax information annually;
2. the government undertake an independent review into the detriment to Australian tax revenue arising from the current transfer pricing regime, and explore options to modify transfer pricing rules or other tax laws;
3. entities with income of a certain level be required to lodge general purpose financial statements with the Australian Securities and Investments Commission;
4. uplift rates for future projects incurring Petroleum Resource Rent Tax be revised to be less generous;
5. "thin capitalisation rules" be amended so that interest deductions are calculated by reference to a corporation's worldwide gearing ratio;
6. the gas transfer pricing method for Petroleum Resource Rent Tax-eligible projects be made simpler and more transparent.
7. the existing voluntary tax transparency code be converted to a mandatory code for all large and medium corporations operating in Australia, including subsidiaries of multinational corporations; and

The ATO, in its submission to the Committee, stated that its recent success in proceedings against the local subsidiary of a large multinational oil and gas group had potentially "changed the game" and that the focus of its investigations in respect of transfer pricing practices will cover other industries, including the pharmaceutical notably.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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

Question 1

We have questions relating to PAYG and the possible calculation of such for the below situation.

We have an employee who has resigned and given no notice. According to their contract, the employee is required to give 3 months' notice and if they do not, then they are required to compensate the council similar as defined in the below clause 14.3.2 of their employment contract.

14.3 Payment In Lieu of Notice

14.3.2 If the "employee" fails to give notice in accordance with this clause, the Local Government may deduct an amount equal to the sum the "employee" would have earned during the notice period from any moneys held by the Local Government and which otherwise would have been due and payable to the "employee".

And as highlighted below in Section 661 of the Workplace Relations Act -

661 Employer to give notice of termination

(4) The required amount of compensation instead of notice must equal or exceed the total of all amounts that, if the employee's employment had continued until the end of the required period of notice, the employer would have become liable to pay to the employee because of the employment continuing during that period.

(5) That total must be worked out based on:

(a) the employee's ordinary hours of work (even if they are not standard hours); and

(b) the amounts ordinarily payable to the employee in respect of those hours, including (for example) allowances, loading and penalties; and

(c) any other amounts payable under the employee's contract of employment.

Our questions are –

- Is this payment (compensation) to the council subject to PAYG, any other form of eligible termination payment (ETP) or payroll tax or GST?
- Should we include super such as the national 9.5% in the compensation?
- I assume we would just raise an invoice to the employee like any other debtor.
- Do we need to advise the ATO of anything?
- Anything else we need to be aware of or take into consideration?

Answer

Simplistically one could say, if the amount is contractually withheld then there is no payment and no PAYG/Payroll Tax implications.

However, if you go ITAA 1997 sect 6-5(4) ….

"In working out whether you have derived an amount of ordinary income and (if so) when you derived it, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct."

It would appear that under the doctrine of "constructive receipt" that as the income has been dealt with on the employee's behalf, then it has been derived and that PAYG needs to be applied. As soon as there is constructive receipt then it is suggested that payroll tax should be applied to the relevant State Revenue Authority on the assessable amounts involved. The compensation should have been deducted from the former staff member's NET entitlements.

Regarding super… we note that unused…. annual leave, long service leave, and sick leave are not included in the definition of "ordinary times earnings." As such there is no need to deduct super.

There is no need to advise the ATO of anything other than to properly deal with the matter in accordance with the doctrine of constructive receipt.

You will of course issue ETP statements to the former staff member and these will be forwarded to the ATO as well.

As there has been no prior taxable supply we do not consider there are any GST implications.

Question 2

The case is this: a client has received $75000 from income protection insurance monthly benefit. This covers a weekly claim from 2009, when the claim was first made up to 2017. A group certificate has been issued with the amount included as Lump sum "E".

From our assessment the amount is fully assessable in the year of receipt. This was the 2017 year, despite it covering 8 years while the claim was sorted. While this seems unfair we seek to confirm that this treatment is correct.

Answer

It is confirmed that this treatment is correct. An individual who is not in business reports income as it is received… on the cash basis.

Question 3

I'm a 58 years old builder, Sole trader and no superannuation. I have a block of land I am currently building on and its sole purpose is being my retirement fund. I sold a speckie this year and a lot of those funds are being funnelled into this project. My question is, can I structure this property and construction as my industry superfund because this is its sole purpose? Also, is there benefit in me structuring as a company or family trust?

Answer

As you are a sole trader, the land is clearly in your name. The only way to structure this as super would be to set up a self-managed super fund (SMSF) but this is problematic.

Firstly, if we are looking at a residence you are building then this is not possible. There is a prohibition on SMSFs acquiring assets from fund members or associates.

There are two exceptions to this rule being ASX (or approved equivalent) shares or business real property.

In the event the build is commercial then to meet the definition of business real property there will need to be business being conducted from the premises.

This will mean there must be a commercial lease in place. As the transfer would have to be at market value, there would be capital gains tax payable by you, as the vendor, and stamp duty by the SMSF as the purchaser.

That assumes that the commercial property had been held for some time... at least 2-3 years and been properly segregated from your main activities as a builder... i.e. not trading stock.

If it is trading stock... then we are dealing with income according to normal concepts with no capital gains tax 50% discount.

- In the event you claim GST input tax credits on purchases along the way, then it will be very difficult to justify the investment position regarding the CGT 50% discount.
- In the event you wanted the SMSF to do the build, then we would advise that this is a bit of a minefield when an associated party is involved, and specialist legal advice would be necessary.

We would not recommend it and in any case, to set up a SMSF you would need to take independent financial advice.

If it sounds all too hard then that's because it is. However, at your age, you are right to focus on Super and you should consult with a reputable, independent financial planner.

As outlined in our asset protection bonus edition there is no harm in getting second opinions and seeing more than one financial planner.

Question 4

Please help with the following query regarding a deceased estate.

When a Testator has died in the U.K. intestate, with relatives in Australia and the estate there is being distributed pursuant to a Court order, are there any duties payable in Australia? At this stage the money is cash being the proceeds of a life policy. Inheritance tax has been paid in the UK.

Answer

There are no death duties payable in Australia. As this is a U.K. Estate, the issues here are very much beneficiary based.

The character of the payments from the Estate need to be reviewed.

If the beneficiary is merely receiving the monetary capital of the Estate, then there are no revenue implications here in Australia.

If the beneficiary is instead, receiving property or shares then capital gains cost base files need to be set up.

For instance, if the beneficiary is receiving post Sept 1985 shares then these are deemed to have been acquired at the same cost as the deceased. So, some tax may well be payable on disposal.

In the event the beneficiary receives income of the Estate or an associated testamentary trust then this is assessable on the gross amount with a credit for any U.K. tax paid.

Question 5

I have some questions regarding claiming a tax deduction for gifts or donations to organisations which are Deductible Gift Recipients (DGRs). Everything we read online and within the Tax Department talks a lot about "property". Does this include "property" such as blankets or drinks etc?

Can you please explain in layman's terms the rules regarding claiming a deduction, for example?

1. A business donates blankets and food to a not for profit charity which is registered as a DGRs. They have purchased these blankets from say Kmart and donated them. This Business has a receipt for these. The DGRs issues them with a receipt for Donation of gifted goods for the value of the Purchase cost. Can the business claim a Tax deduction for donation of goods?
2. A business, or individual pays for Vet bills associated with an animal Rescue case as a donation. The charity is a registered DGR. Can the charity issue a receipt for donated goods and services to the value of the Vet bills, so the payer can claim this as a tax deduction on their tax return or within their business?

It would be great for bO2 to address some of these grey areas as to what qualifies as a deduction when the business donated goods or services.

Answer

1. Yes. If the blankets and food were purchased within the last 12 months.
2. If this payment was made on behalf of the DGR, at market rates and a deduction receipt is willingly issued then that could qualify a money in the below analysis.

This analysis is taken directly from interpretative decision ATO ID 2003/92.

Reasons for Decision

Section 30-15 of the ITAA 1997 and the accompanying table stipulates how and when a gift may be deducted.

Where the gift is made on or after 1 July 2000, a taxpayer cannot obtain a tax deduction for a gift to a fund, authority or institution covered by the above-mentioned table, unless the recipient is endorsed by the Commissioner or is specifically listed by name in the ITAA 1997 or its regulations as a deductible gift recipient (section 30-17 of the ITAA 1997).

Division 30 of the ITAA 1997 provides that a taxpayer will be able to claim a deduction for a gift or contribution made during the year to nominated funds (including prescribed private funds), authorities, institutions or specified persons, subject to the following conditions:

1. the gift must not be made by will unless it is a gift which qualifies under the Cultural Bequests Program (section 30-230 of the ITAA 1997),
2. each gift must be of $2 or more either in *money or property* other than money (for example: land or shares),
3. if property other than money is given, the property must either have been purchased by the person making the gift during the 12 months before the gift is made or be valued by the Commissioner at more than $5,000, and
4. the recipient of the gift must be in Australia (including Norfolk, Cocos (Keeling) and Christmas Islands).

A transfer of property will constitute a 'gift' if the property was transferred voluntarily (Cyprus *Mines Corporation v. FC of T* 78 ATC 4468; 9 ATR 33), and no advantage of a material character was received by the taxpayer in return (FC of *T v. McPhail* (1968) 41 ALJR 346; 15 ATD 16; 10 AITR 552; *Hodges v. FC of T* 97 ATC 2158; 37 ATR 1091).

A motive of benefaction on the part of the donor is also an essential element of a gift (Leary v. FC of T 80 ATC 4438; 11 ATR 145) but this does not have to be the sole motive, and the fact that the donor is motivated also by the desire to obtain a tax deduction cannot, of itself, disentitle the donor to the deduction (FC of *T v. Coppleson* 81 ATC 4550; 12 ATR 358).

In determining the value of the gift of property which is purchased within the previous 12 months, the amount deductible is the lesser of its market value and the amount paid for it (section 30-15 of the ITAA 1997). Where the property was not purchased within the previous 12 months and is valued at more than $5,000, the Commissioner determines the value of the property and thus the amount deductible.

Question 6

I need help in answering these questions relating to "Capital Gain tax & Investment property?"

1. I just want to know whether capital gain tax only applies to investment property (your second house) with rental?
2. If capital gain tax applies to property sold - where your children are living in it without paying any rent in the last 5 years? In other words, it's your second house (investment) and your children are living in it for 5 years already.
3. What happens to investment property without rental for the last 2 years or "NO" rental at all since bought. Does it still attract capital gain tax if sold now?
4. Similarly, say you bought the house 6 years ago, $600K. Rented it out for 3 years. In the last 3 years the house was vacant (no rental) due to a previous house fire. The house now sold for $700K. How do I calculate capital gain tax? or does it apply due to no rental?
5. How do you calculate capital gain tax if you bought the house 7 years ago say $500K, live in that house for 5 years, rent it out for 2 years and now sold it for $700K? Do we get exempt for the 5 years? How?

Answer

1. Each individual or couple is only allowed one principal place of residence (PPR) exemption for capital gains tax (CGT) purposes. There can be two but only for a transition of six months when buying /selling property. The key question here is what name is the title in? If it is yours, then there can be no CGT exemption on this second property. We would alert you to the fact that expenses that have been incurred such as insurance, interest, rates and taxes, repairs et al for which no tax deduction has been claimed can be added to the cost base of the asset… this is often overlooked. If an asset is held longer than 12 months by an individual, then the 50% CGT discount applies on the taxable capital gain. This can also apply to trust and/or partnership distributions.

2. If the title is in your name, not the children's, then CGT may well apply.
3. Depending on the sale price, CGT may well apply and refer to comments in (one) above re the cost base.
4. If you received an insurance pay out, then this must come off the cost base. The cost base includes purchase cost, stamp duties, legal and capital expenses incurred, also refer to (one) above. Calculate the net sale price after commissions, marketing and advertising expenses. Get an Accountant to confirm the calculations.
5. Yes, the calculation is done on the days it was your PPR divided by total days of ownership. There can be up to six years allowed for temporary absence – however revert to prior comments about only PPR at any one time. Typically, the six years is claimed by those who do not buy another PPR and go interstate or overseas for work purposes.

Question 7

My client is a family trust, with a corporate trustee. Operating as a clothing retail store. The manager has been made a bankrupt. The director of the trustee company is his son……

Query – can the son be sued? as the administrator for the bankrupt is chasing the beneficiary loan to the bankrupt circa $100K.

Answer

The corporate trustee can be sued if it owes the bankrupt money.

The loan is an asset of the bankrupt and the administrator in bankruptcy will seek to recover this on behalf of the creditors – it is that simple.

In this instance the son cannot be sued personally unless it can be proven that he, as the director of the trustee company, allowed the business to trade while insolvent. We consider this unlikely but also mention in passing potential exposures with the ATO regarding Directors' Penalty Notices.

First, analyse the loan account which probably is the result of unpaid distributions to the beneficiaries and drawings from the business. Are there any amounts that can be offset such as incorrect postings to other accounts and/or wages for personal exertion?

Even if the accounts were finalised, it is possible to do year to date accounts and/or seek to have these matters taken into account when cutting a deal with the Administrator.

The correct term is "Trustee in Bankruptcy".

Question 8

There are two Trading Discretionary Trusts.

1. Is profitable from Dividends, called Company "A"
2. Is nonprofitable, called "B"

I have a Discretionary Trust "A" that receives only fully franked dividends from the Stock Market i.e. Westpac Bank; Wesfarmers; Etc. the dividends are fully franked at the tax rate of 30%. The Discretionary Trust is profitable. The net income (and the franked dividends) are distributable to another Discretionary Trust, "B" which has trading losses.

The net income from the dividends is offset by the trading losses (B -A), and there is no tax to pay. So, what happens to the franking credits? Does the ATO reimburse the Trustee for the franked dividends? Is there an item number on ATO form where the franking credits are to be paid to?

Answer

The trick here is to ensure there is some taxable income in Trust B to enable the franking credits attached to the dividend to flow down to eligible beneficiaries, who could potentially get large tax refunds if they were on low marginal rates of tax.

In the event the trading losses exceed the gross dividends, then the franking credits are lost and cannot be converted into losses. In the event all family members are on high marginal rates of tax, this may well be an acceptable outcome.

The tax offset and the refund of any excess franking credits are only available where a share of this net income is included in the assessable income of a beneficiary or the trustee.

Therefore, if the trust has no net income or has made a loss for tax purposes, there will be no share of the trust's net income assessed to the beneficiary or trustee, and no entitlement to either the franking credit tax offset or a refund of excess franking credits.

Case study

ABC trust is a discretionary family trust that is negatively geared into a portfolio of direct Australian shares valued at $500,000 with an outstanding margin loan of $400,000. If the trust receives fully franked dividends of $20,000 for the current financial year, it would include $28,571 in its assessable income, being the dividend amount of $20,000 plus the franking credit amount of $8,571. The trust will be able to claim the interest expense of $32,000 (8 per cent per annum of $400,000) as a deduction.

The trust will therefore have a tax loss, it will not be eligible for the tax offset of $8,571 and the franking credit will not be refundable to either the trust or its beneficiaries.

Should the same scenario apply to an individual resident taxpayer instead, the individual could be entitled to a full franking credit refund of $8,571 depending on their individual circumstances and other taxable income...

Franked dividends paid to companies

Companies have their own unique rules regarding the treatment of excess franking credits.

When a company receives a franked dividend, the franking credits attached to that dividend are credited to the company's franking account, which can then be used by the company to frank its own dividends.

Generally, a company (except for certain non-profit companies) with a loss or nil income is not eligible for a refund of excess franking credits. Instead, the excess franking credits of the company may be converted into tax losses, which can be carried forward to offset tax in future income years.

The company may not be able to take advantage of these tax losses until the company generates positive income. If the company expects to run at a loss for a substantial period, it may take some time to recoup the benefit of the losses.

Question 9

Could you please guide me as to the whether the following retention periods are correct when keeping/storing clients records?

- Super Funds – 10 Years?
- Companies – 7 Years?
- Trusts – 7 Years?
- Individuals – 5 Years If Inc Business, Or 2 Years If Only Basic?
- Partnerships – 5 Years?

Also, if a client has left (say after 3 years) can the hard copies of tax returns, workpapers etc be destroyed? (copies of the tax return would remain electronically) - presuming this would only apply to individuals and partnerships?

TRUST ACCOUNT records – I have been told 7 years but have read 10 years?

Answer

To answer your questions... you appear to be largely correct as follows....

Under SISA, super fund trustees must keep records for 10 years and their accountants should follow suit.

Again, under the Corporations Legislation, Company Directors are responsible for the retention of records and this stipulates 7 years. As an overwhelming majority of trusts have corporate trustees, 7 years apply as above to retention of records. For individuals and partnerships both operating businesses, 5 years does apply, but note it is from the date of assessment, so be careful with those late lodgers.

For individuals it is two years but, in the event of fraud, evasion or audit amendments to trust distributions (et al) the ATO can go back further. There are also potential division 7A assessments which flow down to individuals. For those individuals who are part of family business groups and/or have potential exposure to these issues it may be wise to retain for five years and in fact many accountants still retain for five years.

Regarding Trust Accounts... as you are in Queensland the requirement for retention of records is 5 years.

Question 10

Could you please clarify for me in the case below when if a loss is capital or revenue or can the loss be offset against any income?

Example: N Pty Ltd has a loan to P Pty Ltd for $91,000. P Pty Ltd goes into liquidation and no value is realised, the Liquidator advises no amount will be paid back. Therefore, N Pty Ltd can write off the loan to P Pty Ltd. N Pty Ltd makes a revenue profit of $71,000 for the year.

Can N Pty Ltd use the loss on the loan to P Pty Ltd and result in a $20,000 loss? i.e. Profit of $71k-$91k loss = $20k loss.

Answer

Unfortunately, the following applies:

We surmise that N Pty Ltd is not in the business lending and that it conducts some other income earning activity.

As such this loss cannot be on revenue account and cannot be offset against the $71k profit. Potentially it is a capital loss and we would refer you to our answer in issue #0092, Q15 page 11.

The key here is whether interest was charged on the loan – this will allow it to be a capital loss. If not, then it is necessary to demonstrate that the loan arose from N Pty Ltd carrying on a business (see s108-20 ITAA 1997).

A capital loss can be carried forward indefinitely but may only be set off against capital gains.

Question 11

We would like to obtain your advice on a topic that we were unable to find within the tax essentials manual - relating to R&D grants.

Scenario: Whispering Waters Pty Ltd is trustee to Whispering Waters Unit Trust (UT) with the UT holding all the assets, profits/loss and business dealings. The Unit Trusts legal liability gets pushed to the Whispering Waters because it is the trustee and so helps to protect Unitholders of the UT. As the assets are held by the UT; the UT is eligible to a 50% capital gains tax discount when selling the assets. Unitholder Companies get their proportioned share distribution of the UT's profits and pays tax accordingly. The company is used to park the tax paid and can pass Franked Dividends (FD)and Franking Credits (FC) to the Family Trusts when beneficial. The Family Trusts then can pass the FD's and FC's to their beneficiaries to minimise tax by maximising the benefit of the FC's. Assumption: that all business entities are profitable.

1. Are R&D grants available to Private Unit Trusts with a corporate trustee?
2. Is there any way to structure the Unit Trust to be eligible for R&D grants?
3. If part of the R&D process is to be done overseas, does it still qualify for the Australian R&D grant?
4. What is the criteria needed to satisfy for a R&D grant if the entity is creating computer software applications?

In Addition,...

If the entity is structured (refer to diagram provided) and the purchaser is only interested in buying the application and not the company; would we be right in assuming that this structure would not entitle them to the 50% CGT discount but would qualify for the R&D grant?

Answer

To answer your questions:

1) R&D Grants are not available to private trading trusts with a corporate trustee.
2) Possibly as a public trading trust (the only exception) but due to the compliance and regulatory burdens, it is very unlikely that this will be feasible.
3) Overseas activities require special approval – what you do here is apply for an overseas finding. Generally overseas activities will only be eligible if it can be demonstrated that the activities cannot be conducted in Australia.
4) Refer to www.business.gov.au/assistance/research-and-development-tax-incnetive/guidance as this contains several examples.

The diagram notates unitholders which appear to be simple companies with no underlying trusts – if this is the case then it is correct to say that such a company a company cannot access the CGT discount.

Regarding the R&D Grant... the eligible activity would need to be conducted (and expenditure incurred) by this company after carefully reviewing the guidelines and taking appropriate professional advice.

Question 12

Can you confirm the following P&L and Balance Sheet...?

Summarised as:

P&L Net Profit for year	$81,742
Balance Sheet	
Cash	$55,828
Debtors	$24,585
Loans to directors	$45,192
ATO Debts	$93,403
Retained Profits/(loss)	(49,539)

Net Assets are $32,202 including the directors loan.

Sec 109Y (2)

Net Assets + Div 7a Amounts – Non comm Loans – Paid up Share Value – Repayments of Non-commercial Loans

Is the distributable surplus calculated as?

Net Assets = $32,202

+ Div 7a Amts: Nil

- Non Comm Loans $45,192

- Paid up share $1

- Repayments Nil

= -$12,991

Assuming the above is correct, then a Div 7 Divided is declared. As there is no surplus to distribute, then there is no dividend. Is my understanding correct?

Answer

This would appear to be correct as the amount to be taken as a dividend cannot exceed the company's distributable surplus s109Y ITAA 1936. This is calculated at the end of the relevant income year.

From your worksheet you have correctly used the formula in s109Y (2) to work out the distributable surplus and this does not always equate to retained earnings.

Question 13

Is the 9.5 SGC applicable to Annual Leave being converted into CASH.

Answer

When you say "converted into cash" we take this to mean annual leave paid out on the basis the employment continued. – this would be included in ordinary times earnings and statutory superannuation would be payable.

This compares to unused annual leave paid as an ETP – here the SG is not payable.

Question 14

I have received a small business declaration form which exempts small businesses in NSW from being taxed on insurance policies under the meaning of section 152-10 (1AA) of the Income Tax Assessment Act 1997 of the Commonwealth.

I assume that the insurance broker and the real estate agent/manager believe I am a small business because I own property that is leased out. Indeed, that is what I do for a living. However, in the past my accountant has decided that all these benefits which have been provided for small businesses are not claimable by me. He says I am not a small business. (I am not a large business.) I own a small portfolio of property, some residential and some industrial.

There is no definition of a small business on the form or on the website. The Tax Department web site has reams of tax legislation about small businesses. I read a couple of them but could not find a definition there either.

If I turn out to not be a small business, my insurance policies will be invalidated, if I sign the form.

Answer

The section of the act you refer to, defines a business in the context of the Capital Gains Tax Small Business Concessions.

If you solely receive passive income from being a landlord and investor, then in our view you are not a small business.

Question 15

Please see below the following tax queries:

1. Pre GST-principal residence on one and half acres. House and half acre subdivided and sold. One-acre vacant land now ready for sale – any tax implications?
2. Pre GST-principal residence of parents passed onto daughter following their death. Daughter has rented out property for past 15 years approximately and is now wanting to sell - any tax implications?

Answer

We take references to "GST" to mean "CGT" i.e. capital gains tax.

1) The land will retain its pre-CGT status and for a development of this scale, there will be no tax payable upon sale.

2) For this pre-CGT dwelling, the daughter is deemed to have purchased the asset at market value at the date of death of the last surviving parent. For the dwelling to have not been subject to CGT it would have needed to be disposed of within two years.

Question 16

I wish to obtain some advice regarding Capital Gains Tax.

My daughter purchased a townhouse in Penrith NSW on 25.9.07 for which she received "first home owners grant"- The property was being rented at the time and the tenant continued to rent it until August 2008.

In August 2008 my daughter occupied the property as her principal place of residence until November 2009, when she had to move out for personal reasons (took on Part Time work to complete post graduate studies at university). The property was rented out from November 2009 to May 2011.

In May 2011 she again occupied the property as her principal place of residence until November 2011, when she was offered a position in Sydney and found traveling too difficult she moved out and the property was rented out until sold in April 2018.

Question - *Is she entitled to claim CGT exemption?*

Answer

On the basis, there is a taxable capital gain, some tax will be payable ...

This question is answered on the basis that your daughter had no other Principal Place of Residence (PPR) in the periods we are dealing with. This is very important, other than 6 months' transitions, a taxpayer or couple is only allowed one PPR at any one time.

The amount of tax is reduced by applying the six-year temporary absence as follows:

1) 25.9.2007 to August 2008 for whatever reason daughter had not moved in, so this period is taxable.
2) Aug 2008 to Nov 2009... PPR not taxable.
3) Nov 2009 to May 2011... it is possible to apply the six-year temporary absence, so this period is not taxable.
4) May 2011 to Nov 2011 PPR not taxable.
5) Nov 2011 to Oct 2017 the six-year temporary absence has been "freshened up" by daughter moving back in so this period not taxable.
6) Oct 2017 to Apr 2018 this period is taxable.

Note: the calculations will need to be on the days in the year basis and will need to be precise. There will be tax payable but for most of the period the dwelling will be your daughter's PPR.

Without going through the mechanics of a CGT calculation, let's just say the net gain is $150,000 and your daughter's marginal tax is 34.5%.

One and Six above are the taxable periods, i.e. 18 months in a total period of ownership of 127 months.

The CGT payable in this instance would be $150K less the 50% individual discount times 18/127 times 34.5% = $3,667.

Question 17

Do the changes to the depreciation rules also apply if I own a rental property within a company structure?

For example, if Company ABC purchases an apartment on 2 Feb 2018 and it has an existing dishwasher in the apartment, can I depreciate the existing dishwasher? If I was an individual acquiring the apartment I can't depreciate the dishwasher unless I purchase it new, but I'm not sure if this same rule applies when you are a company.

Answer

As these changes do not apply to corporate structures you will still be able to claim depreciation on the dishwasher.

Question 18

My client has a construction business that is operated inside a family trust with a corporate trustee, this same client has also setup a Family trust with a separate corporate trustee and purchased a factory at the beginning of the 2018 financial year.

Their intention was to lease the factory to their construction business. My client's construction business has been using the factory during the year, however, they would now like to know if they can choose to not pay rent to the family trust that is holding the factory. Effectively increasing the profit in the construction business and not declaring an income to the family trust that holds the factory. The end result being; the family trust that has the factory would not claim any income or expenses (interest would be capitalised to the cost of the asset) and the construction business would also not claim a rental tax deduction either.

My question is, do we have to pay a lease from the construction business to the family trust for the use of the factory, or can we renegotiate the lease agreement that was entered into at the beginning of the year to give a period of rent free use of the factory to his construction business? Or does a lease agreement have to be at market value at all times?

Answer

It sounds as if some sound asset protection planning took place which your client seems to now want to undermine for the sake of a little inconvenience.

Firstly, the asset holding trust (AHT) is incurring interest expenses and in the event of there being no rental income being earnt.... The interest deductibility (and outgoings) could be called into question.

A formal lease is in place... this means that the trading trust (TT) will owe the AHT for rent.... in the event of TT having insufficient funds to pay rent, income can still be taken up (debtors) in the AHT and a tax deduction claimed in TT.

It sounds as if your client simply can't be bothered implementing a sound asset protection strategy. They should be told that it was done this way for a reason and they should go to the effort of opening a bank account in the AHT, organising the direct debits and spending a little more time on bookkeeping.

As this is our asset protection bonus edition, this question is very timely.

Question 19

I have a query that I would appreciate some help on. A band from New Zealand has approached us. They're about to go on tour here in Australia and they have asked if they need to register for an ABN? I guess they would be a partnership of sorts, but would they need to register for an ABN while touring and charging venues for their performances? If so, I suppose they would register as a foreign entity? Furthermore, would they need to do a tax return in Australia and subsequently apply for tax file numbers? I suppose that any tax they pay in Australia would be credited to them when submitting their tax return back home in New Zealand? This has come up because venues are asking for tax invoices from them.

Answer

The Foreign Resident Withholding arrangement which applies to both individuals and non-individual entities was introduced on 1 July 2004 and is part of the Pay As You Go withholding system.

Australian payers are required to withhold an amount to cover expected income tax liabilities on payments made to foreign residents being paid for providing entertainment.

Generally, under Australia's international tax treaties, income derived by foreign resident entertainers is taxed in Australia. Therefore, the entertainer will need to apply online for a TFN and ABN and is required to lodge an income tax return. For a foreign entertainer to apply online for a TFN and ABN, a passport number is required to prove their identity.

The Australian payer is required to supply a foreign resident with a Payment Summary. The foreign resident entertainer will then need to report these amounts by lodging an Australian Income Tax Return with the amounts withheld claimed as a credit against the tax assessed. A Notice of Tax Assessment will be issued after the lodgement of the tax return. The Notice of Assessment will be proof of tax paid in Australia and a credit for the tax can be claimed in the foreign resident's home jurisdiction.

If the foreign resident expects to incur tax deductible expenses which will reduce their taxable income a Foreign Resident Withholding (FRW) application may be lodged, prior to lodging an income tax return. The reason for this type of variation is 'tax deductible expenses'. A Tax File Number and Australian Business Number is required when applying for this type of variation. A foreign resident's actual tax liability is determined following the lodgement of their tax return and not only by the lodgement of an FRW application.

Foreign entertainers from the United States are exempt from paying Australian tax where gross receipts do not exceed US$10,000.00 for the taxable year. A US resident entertainer under these circumstances may apply for a FRW variation based on 'tax treaty applies". A TFN and ABN is not required when applying for this type of variation. Proof of identity of the foreign resident is however required. Also, lodgement of an income tax return will not be required.

A fact sheet on 'Foreign resid¬ent PAYG withholding' can be downloaded from www.ato.gov.au

Leigh's Corner

Article No.42

SICKNESS IN THE WORKPLACE

This time of year (winter) brings its own form of unique challenges to the workplace due to the presence of a multitude of viruses and illnesses in the general community which invariably make their way into the workplace.

The most common diseases present at this time of year range from the common cold and general unpleasant viruses through to influenza (flu) which is one of the most serious of the viruses.

Unfortunately, people are exposed to contagious diseases at many levels of the community through casual contact with people and surfaces, and the viruses are easily picked up and spread.

Many parents and grandparents are exposed to viruses picked up from their children who attend day-care or school and they then attend work and spread these viruses further afield.

In major cities unfortunately, many employees travel to work on public transport and are in confined spaces with large numbers of the general public, many of whom may be in various stages of contagion.

It is particularly difficult to avoid close contact with others under these circumstances and there is a higher risk of picking up some type of cold or flu when using these types of transport.

It is particularly difficult for those employees who travel frequently on aeroplanes as the air, although frequently filtered, is recirculated and you are also forced to be in close proximity to people who may be sick or contagious or both

The difficult balance that sick individual employees and employers face during the "flu season" is managing their work attendance and productivity while minimising risk to others.

All employees and workplaces are different, and the behaviour of individuals varies greatly with a number of typical groups such as:

1. The martyr who never takes sick leave, and attends work no matter what symptoms they are suffering from and is a high risk to other employees and clients.
2. The serial sick leave offender who at the slightest symptom of illness is absent from work.
3. The worker bee who just keeps on coming to work and doing their job while trying to avoid people who may pass on their illness to them.

In a workplace where an employee, or a number of employees, are exhibiting the symptoms of a contagious disease such as coughing, sneezing, runny nose, watery eyes and raspy throat, other employees have a right to be concerned that they may contract a virus or disease as part of their daily work.

Employees who have a medical condition or conditions such as asthma and associated respiratory illnesses, heart conditions, allergies and many other conditions may face significant risks from illnesses at this time of the year.

There are steps that an employer may take to attempt to get through this period with the least possible impact on both employees and the workplace and these steps include:

1. Advising all employees to take appropriate precautions while at work such as coughing into their elbow, not leaving used tissues in the workplace, constantly washing hands and being aware of other employees and their proximity to others if unwell.
2. Advising employees that if they are unwell and may be contagious that they should consider staying at home until the symptoms ease or disappear.
3. Advising employees that they should take appropriate precautions when travelling on public transport and aeroplanes to minimise their likelihood of catching a virus (e.g. wearing a mask).

It is a delicate balancing act for employers as they do not technically have the right to direct an employee to leave work and go home based on an assessment that they may be too sick for the workplace, as each individual employee is entitled to attend work if they feel able to do so and are only entitled to take sick leave (for permanent employees) when too ill or injured to attend work.

However, the employer under the relevant Workplace health and Safety legislation has an obligation to provide a safe workplace for employees and to identify and manage risks at the workplace.

An employer may approach an employee who appears to be showing symptoms of a communicable disease and request that in the interests of the other employees and to maintain a safe workplace so that the illness does not spread and affect other employees and/or clients and customers, that the employee takes sick leave until the symptoms being displayed and the level of contagion are reduced or gone.

As a general guide, a basic definition of a communicable disease is a disease that is carried or transmitted from one person to another either directly or indirectly.

Such diseases are caused by a variety of microbes including bacteria, parasites, fungi and viruses.

At present the best way to protect all employees from these more common infections is through preventative strategies aimed at limiting exposure.

Employees should be advised that it is assumed and expected that each and every employee will exercise a duty of care to others.

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

Want to know more about our HR/IR Smart Guides, Smart ToolPacks, WHSmart Safety Essentials and other business related online services......... If you have question for Leigh's team send us an email info@bO2.com.au

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Your Notes

Special Bonus Issue

WHAT'S NEW IN 2018?

- Major reforms to Australia's debt agreement system
- An insolvency safe harbour for company directors
- Bankruptcy 101…options for individuals in difficult times including divisible and non-divisible property and periods that apply
- One-year bankruptcy – we advise on progress of legislation
- Changes to Corporations Act to combat illegal phoenix activity

And once again we're highlighting an old favourite…. "The Client and the Adviser" given recent events it remains pertinent and is definitely worth a read.

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 the way matrimonial assets (including those assets brought to the relationship by the parties) are to be divided in the event of separation. A BFA can be drafted to take account of specific assets in existence at the time the agreement is made and/or those acquired subsequent to the agreement.

The subject of entering into a BFA can be difficult to broach – however, it does give both parties certainty as to how assets are to be divided in the event o relationship breakdown.

Although a BFA may not always be completely 'water tight', it can provide the parties with a level of certainty in relation to the distribution of assets on a marital breakdown.

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

- The agreement has been signed by both parties.

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

- The effect of the agreement on their rights, and
- The advantages and disadvantages of entering into the BFA.
- Each spouse was provided with a signed statement stating that the advice was provided.
- After the agreement is signed, 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 which is 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 our unenforceable.
- In the event circumstances have arisen since the agreement that made it impracticable for the agreement or a part of the agreement to be carried out.
- Since the making of 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 in one to two years this could lead to a public listing.

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 with a view to attracting future investors. Typically, we have an entrepreneur who is aiming high, is hands on and has an unshakeable self-belief…

Never would we want to dampen the entrepreneurial spirit in any way – these people achieve great things and we commend initiatives such as the 'National Innovation and Science Agenda'.

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 while 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 balances establishing the position with company lodgements and debtors GST, PAYG, company tax and other liabilities.
- Sighting legal opinions/advices 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 checkered past.
- It is very easy to make discreet inquiries and do internet and /or A.S.I.C. searches on the relevant individuals.
- Do the research yourself while seeking out independent parties in the industry for a second opinion. Do not take anything as face value.

Finally, how well do you understand the technology and the market the company operates in?

Never forget… cash flow in a start-up is everything and beware the charismatic chairman who does not make full disclosure on these issues at board meetings.

SURVIVAL CHECKLIST FOR COMPANY DIRECTORS

1. Do 'Quick Analysis' on at least on a Quarterly Basis. This is the ratio of current assets divided by current liabilities in the company's balance sheet. A quick ratio of less than one is 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 market place and the sometimes rapid changes and challenges. Always question the on-going 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 on a monthly basis.
7. Be particularly careful with a start-up – it is very important that the business model 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.

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 very 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.

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 3 months late leaving the company owing 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 an individual for.

There are other exposures but the above are the most common.

Anyone can understand 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 directors 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 serious blow to their turnover, at the same time their two biggest clients, both large hotels, decided to take these functions in-house. Two thirds of their turnover were 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 for 250k existed. With the ATO pressing, the owners went to their lawyers who worked out a payment plan. This 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 6 months before liquidating the company. This avoided 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, in the event of the business being unviable, closing the business or liquidation is a real option. It is illegal to continue to trade when insolvent. A reputable accountant could have given advice in 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. Clearly here, there had been a lack of planning and asset protection structuring. Fortunately, in this case, the business owners got the advice that their business was no longer viable due to technological obsolescence and unlikely to return to profitability. The business was closed down in an orderly fashion and the commercial property retained. Again, this couple is in their sixties, but here they are, able to contemplate a comfortable and secure retirement.

Unwelcome Advice......

This is certainly 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? In these cases, a second opinion may be sought 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, then a serious problem exists, and it needs to be addressed immediately. Realistic budgets need to be prepared for the business to establish ongoing viability. In many cases there may just be a seasonal lull 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 being the business to its knees. Quite often one owner shields their spouse from the real situation. Sadly, in the absence of firm and objective advice, the situation just gets worse.

It really is the role of the "Trusted Advisor" to be honest and forthright with their client. Accountants may lose fees but it imperative that they act in the client's best interest at all times.

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 on 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 are holding on trust for the ATO including GST and PAYG 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 useful, but they are dismissed by the client as impractical or too expensive.
- The client expresses concerns about his business future and the subject of asset protection is aised. 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 seem too hard. The client laments "in any case the bank owns me."
- The client agrees to give the matters aised some thought…
- Nothing happens but the adviser has made file notes concerning his advice which he may use to later salve his conscience…
- Two and a half years later the business goes into liquidation, the client is found personally liable for the insolvent trading and when credit card debt taken into account, there is the real prospect of losing the family home.

Nothing happened! It all seemed too hard at the time

But this really 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:

- 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 which held no fixed assets should have been formed to operate the business under licence in order to isolate risk.
- Normal 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 unless he was willing to implement changes to ensure his business survival, he should sell or close his business.
- Brutal but honest advice was clearly called for.
- 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 often in family business this should squarely focus on the principal(s).
- With the client exhausted and in denial, basic break-even analysis is crucial with the client clearly aware of the required turnover and gross profit figures required each month for business survival.
- Further to this the client should have been clearly 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 a good provider to his family and is well respected in his community. His children are well educated and have been given an excellent start in life.

- He has good technical skills and sound business ethics.
- However, exhaustion and fatigue has 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 take note.

This outcome…

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

RESTRUCTURING BUSINESS

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

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 important to properly assess the actual risk. Most clients require external finance to fund their business assets and operations.

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

In this context the decisions concerning business structures may not have a lot of impact on 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.

It is fundamental that you avoid holding personal or passive investment assets in the same entity that carries on their business activities.

This should not involve complex structures or significant costs – particularly if the asset protection issues are considered at the outset.

A married couple who operate 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 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 to 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 the recommendations will be to set up some offshore structures.

This will sometimes occur in cases where there is no good reason to do this. It just means expensive and unnecessary structures.

Quite often the decision of Justice Robert French 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, is given as the reason an offshore structure is necessary.

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 structures which are unnecessary and very expensive.

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.

In recent times, we have seen a number of cases of "Whistle blowers" with explosive "Wiki Leak" style revelations. One of the most notable being 11.5 million documents known as the "Panama Papers" leaked from leading offshore law firm Mossack Fonseca in April 2016. This trend continues 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 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 common sense. But the employees were hired under a contract of service for the provision of labor only, and therefore 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. Certainly, this is an extreme example, but it is common for employers to encounter large superannuation and payroll tax liabilities because they have not bothered to check their exposures for "subcontractors" under the relevant statues.

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

- 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 properly budget for PAYG tax and other cash outflows forces a level of discipline in a business.
- Employers who "don't want the admin headaches" on relatively simple matters usually can't be bothered with business strategies in what has become a very difficult business environment.

The contractors versus employers' issue is an area of audit focus for the ATO. From practical experience these matters normally 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 an awareness and sophistication; and this in itself 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. With the passage of time some of these are not even properly utilised or implemented.

A balance is required – you need to have a clear understanding of your situation and also 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 don't 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 and 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, it has become very clear to this tax practitioner that many clients do not understand advice they receive from some Financial Planners.

Once again, a leap of faith was involved with risky and inappropriate investments the result being many people, particularly older persons, are never going to recover their position because of 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? Don't 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 small deficiencies in structures can have significant tax impacts, threatening the effectiveness of existing arrangements and structures.
- The end of the mining boom 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.
- Compounding this, banks are lifting interest rates independent of RBA adjustments.
- The commencement on 30th January 2012 of the Personal Property Securities Act 2009 has had a major effect on 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 should be distinguished from investment situations. 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, the following must not be overlooked.

- 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.
- **Continual changes in legislation (see above) and legal precedents.**

ASSET PROTECTION CHECKLIST

1. Property Transfers between Spouses
   - Consider Bankruptcy Act 'clawback' provisions which may defeat pre-bankruptcy transfers.
2. Are assets held in Company or Trust entities or in Personal Names?
   - Business conducted in 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 loans from stakeholders to the business operating entity are appropriately secured with mortgage debenture, mortgage registered charge or other securities.
7. In appropriate circumstances, 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 ownership of intellectual property assets from business.
   - Use of small business CGT provisions to move business away from property assets.
   - Consider the more complex strategies that may be available.
9. Consider whether appropriate to transfer assets to a superannuation fund but note the proposed changes to apply from 3.05.2016, announced in the May 2016 Federal Budget.
10. Once problems arise, seek professional advice to implement an appropriate strategy which may be utilised 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 which can have no possible purpose except to confuse where trusts and the law of trusts is concerned.

Trusts stem from the feudal system under which the Crown did not part with ownership of land, but rather 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. That is, 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 and is referred to as the beneficial owner. At the end of the day 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 and how the obligations of Trustee are to be discharged and what the entitlement of the beneficial owner is, hence: In the case of a discretionary Trust there is a settled sum which establishes the trust and a series of rules that enable the Trustee to discharge the duties of Trustee and to determine (albeit by the way of application of some formula) who the beneficiaries are or are to be, and In a Unit Trust there are defined units with a specific and defined value and similarly a set of 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 draft legislation to implement the change was prepared. Due to pressure from the National Party and the business community the entity taxation regime was eventually rejected by the government.

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

- 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 the bankruptcy legislation to 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 which calls into question the level of asset protection a discretionary trust can provide if one of the core people involved in the trust individually become 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 which 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.
- The Bamford High Court decision and recent Decision Impact Statement released by the Tax Office in relation 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
- Numerous changes to the application of the Division 7A regime to capture and tax many arrangements where unpaid present entitlements had arisen following a distribution from a discretionary trust.

Discretionary Trusts

A Discretionary Trust is a legal entity where there is a Trustee who 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. The rights of beneficiaries in a Discretionary Trust are limited to a right to be considered for nomination by the Trustee and to compel proper administration of the trust only.

A Discretionary Trust is established by way of a Trust Deed entered into between the Settler and the Trustee. The Trust Deed regulates the way the Trustee can exercise its discretion. The Trust Deed provided by this service 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, as well as containing 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 a flexibility in how the income is distributed,
- estate privacy.

Unit Trust

A unit trust is a common investment vehicle which 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 while the trustee acts as a guardian of the interests of the unit holders.

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

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.

Superannuation Fund

A Superannuation Fund is a trust, in the same way as a family discretionary trust, however it simply has a limited and special purpose. Currently there are over

570,000 surging more towards 600,000 Self-Managed Superannuation Funds in Australia controlling $650B+ in assets. Given recent incentives offered by the Government, they are increasingly popular as wealth accumulation vehicles with asset protection benefits.

Hybrid Trusts

The hybrid trust has the feature of both a discretionary trust and a unit trust. The hybrid trust is based on the standard discretionary trust with the added feature that it 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 next 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 and 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 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 as response to it) remains an effective mechanism in protection of wealth.

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

Where the trust arrangement cannot be challenged then the bankruptcy trustee is limited to a passive role as in circumstances where there is 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 it is only the Bankruptcy Act's remedies which 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 can target 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. The increasing sophistication of financial services however, 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 settler *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 to any purpose pursuant to the trust, depends on the exercise of the trustee's discretion.

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

Exposing Sham Trust Arrangements

Perhaps the most straight forward 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 real 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

If after a beneficiary becomes bankrupt the trustee pays money or transfers property to the bankrupt, 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 conferred by the trust instrument.

Where the beneficiary’s interest in the trust is a, mere discretionary interest, the right to be considered for the purposes of 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 impugned.

The trustee may consider when exercising its discretions:

- Information given to them personally or in 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 directions of the beneficiary, 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 settler. A trustee is not a delegate of the creator of the trust or of the beneficiary and neither of them can 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 would jeopardise the supervisory jurisdiction of the courts.

Various cases have provided that trustees are to:

- Give effect to the intention of the settlor 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 settlement, the surrounding circumstances, and their individual knowledge acquired or inherited…
- Inform themselves before planning on 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 at the time when they exercised their powers, which may be different from those at the date of the creation of the trust.

Where a trustee exercises a discretion, it may be impugned where exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelevantly or without giving a real or genuine consideration to the exercise of the discretion. Where a discretion is expressed to be absolute, it may be that bad faith needs to be shown.

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 for the benefit of the beneficiaries of the trust, rather than their creditors. 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 his or her 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 be able to 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 who is already in the midst of a financial crisis. Even here, however, steps can be taken, albeit cautiously, to protect assets.

Richstar

This 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.

The decision was of concern to those who have long sought the shelter of discretionary trusts for the protection of assets from the reach of creditors. As outlined the discretionary trust is a widely used asset protection tool on the basis that the beneficiaries of the trust do not (at least on the face of it) have any interest in the assets or income of the trust until they are distributed by the Trustee.

In one sense the Richstar decision might be seen as a radical incursion into the private asset structuring arrangements of individuals. One view is that the decision merely makes it clear that as in the case of sham transactions, the Court will in certain circumstances look through the form of asset protection arrangements. Those of us with discretionary trusts need to carefully consider the Richstar decision.

Whilst a detailed discussion of Richstar is clearly beyond the scope of this update, it is clear that each matter will be considered on its own facts, each trust on its own terms, and each question of control and ownership in light of its own circumstances.

The message is clear for asset protection purposes. Only by clearly 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 beneficiaries control.

Whether this is practical is another matter. Will clients feel comfortable receiving this sort of advice from their professional advisors? On paper they are being asked to give up direct control of their trust structures. The most appropriate structure will, as always, depend on the circumstances. It is important to consider:

- What does the trust do?
- What do the individuals benefiting from the trust do?
- What are their legal areas of risk exposure?

Be warned, insolvency practitioners will also look more closely at the way in which discretionary trust 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.

Richstar Summary

The day is definitely coming where a Bankruptcy Trustee will definitely argue that either a husband or wife (or both) have a contingent interest in the asset of a family trust.

The consequence is that those assets are divisible among their creditors. To make it harder to access those assets, 'at risk' appointors, beneficiaries and trustees should be removed. Consider whether it is possible to appoint independent appointers and/or trustees.

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 recent case because it demonstrates how a suitably drafted Trust Deed may assist in protecting a Trust from deregistration of the Trustee and bankruptcy of its Director. This is not an uncommon situation.

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 (as well as the income derived from these assets) of the trust into account.

The key here is 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 breakdown. The clear objective here is to avoid the trust assets being treated as property of the parties but also to avoid the trust being treated as a financial resource if the outcome is that most if not all the non-trust assets are given to the other spouse.

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 actual history of the trust including any changes when the marriage started to go bad.

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.

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

It is stressed that you should seek specialist advice.

Key cases include:

- Milankov and Milankox (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

SUPERANNUATION

A key feature of the 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 of 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:

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 own 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 main purpose in participating in the arrangement was to defeat creditors,

c. Provide that consideration given by the superannuation trustee for the contribution will be ignored in 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 made with the intention 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 that are holding the contributions that will put a freeze on the funds to prevent 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 are able to prove that you were solvent when the payments were made.

Self-Managed Super Funds and Bankruptcy

Most SMSF are managed by a corporate trustee, 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 take part in the management of a super fund.

Clearly if a bankrupt cannot be a director of the trustee of a SMSF he also cannot be a member of that fund, and his entitlements will need to be otherwise dealt with. 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. That is there is no period of grace in relation to acting as a director. This means 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 simply to have that interest transferred to a larger fund, within the six-month period of grace. This is not a transaction which the trustee in bankruptcy can frustrate, unless he or she believes that that interest includes contributions which should not have been made and which are recoverable under section 128B of the Bankruptcy Act.

Another option is for the members’ entitlements to be paid out, if 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 have been 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’s 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 to be taken as being authorised by the debtor and/or 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 is indemnified for doing so.

Superannuation funds by nature are supposed to be a protected source of money and 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 the case of Denlay v Commissioner of Taxation a garnishee was issued over the taxpayers’ superannuation fund, at this time the parties were part way through the hearing of appeals filed by the Denlays to amended income tax assessments made by the ATO, and 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 debtor’s petitions and Mr Denlay was not able 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 Denlay’s 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.

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

The Victoria Supreme Court (VSC) found that the sole director of a family trust company had breached fiduciary duties owed to the company by diverting company funds to a family superannuation fund and a personal bank account. The Court found that the director had failed to act in the interests of the Company, exercised his powers and duties for a collateral and improper purpose, and did not avoid conflicts of interest. However, the Court considered the company (in proceedings brought by the receivers and managers) could not succeed in its claim against the trustee of the superannuation fund, as there was not knowing receipt of trust property by the fund trustee which gave valuable consideration for the superannuation contributions accepted in good faith and without notice of the breaches of fiduciary duty.

Specific Requirements

All members of a SMSF must be the trustees of the super fund. In the event the trustee is a company all members must be directors of the corporate trustee. If a member becomes bankrupt or is subject to a Part X Personal Insolvency Agreement, these people are no longer eligible to be trustees of the SMSF or to act as directors of corporate trustees.

The flow on effects of being a disqualified trustee includes:

- You cannot act as a trustee. This is an offence which may lead to fines and/or imprisonment. It may even be an offence for the other trustees who allow you to act as a trustee when they know you are disqualified.
- You or the other trustees/corporate trustee must notify the Australian Taxation Office (ATO) of the disqualification within 28 days of the change in SMSF members.
- The SMSF then has six months to either:
  - Roll your benefits out of the fund.
  - Appoint a small fund trustee who is licensed by the Australian Prudential Regulation Authority (APRA). Australian Executor Trustees and Perpetual Limited offer these services and it costs about $7,000+ to set up and $2,000 in annual fees.
  - Wind up the fund.

If none of the above options are actioned, the fund automatically becomes ‘non-complying’ and will pay more in tax.

There has been considerable growth in SMSFs, including some that are buying investment properties using debt. In this scenario when a SMSF member goes bankrupt, you can’t roll the bankrupt’s benefits out of the fund. If there is little or no equity in the investment property, due to market conditions then you sell at a considerable loss.

And so, to summarise your SMSF Super is safe if:

- It is not paid into super in breach of a duty owed to another;
- There was no knowing receipt by the trustee of the super fund of such a breach;
- The trustee of the super fund accepted the consideration when accepting the contribution;
- The superannuation contributions were not made to defeat creditors;
- There is no amount that is due and payable under the superannuation fund rules to the person;
- And if there is an amount that is due and payable, yes, it is if the person is already bankrupt;
- Or if there is an amount that is due and payable, and the person is not already bankrupt, possibly yes, it is if;
- Another person or persons have a non-defeasible present interest in the non-bankrupt member’s superannuation, but;
- Not to the extent the non-bankrupt member has a vested interest entitlement in super that is presently due and payable;
- Note that deed provisions that cancel a member’s interest in super due to an insolvency event are avoided.

SMALL BUSINESS ROLLOVER AVAILABLE FROM 1 JULY 2016

Laws now allow small businesses to restructure into a different legal form without triggering income tax. This concession enables many small businesses to unlock structures which are no longer ideal from a commercial, legal or tax perspective.

For any variety of reasons, many small businesses operate through less than ideal legal structures.

However, once a business has been operating through a structure for a period of time, it often becomes valuable and cannot easily be restructured without incurring significant tax liabilities.

Leaving aside existing rollovers, the new rules are far wider in their potential application and will allow entities running a qualifying business, and certain related entities, to transfer any 'active asset' to another qualifying entity without tax.

These measures apply to Small Business Entities (SBE) (including partners in an SBE partnership) or an 'affiliate' or 'connected' with an SBE. An SBE is an entity that conducts a business with estimated turnover for the current year of less than $2 million, or turnover for the previous year of less than $2 million. Both the transferor and transferee must meet these requirements.

The rollover is optional and available where an active asset is transferred from one eligible entity or another as part of a 'genuine restructure' where the 'ultimate economic ownership' of the asset does not change as a result of the transfer.

The term 'genuine restructure' is not defined however a safe harbour rule has been included which says there will be a genuine restructure where, for the three years following the roll-over:

- There is no change in the underlying economic ownership of any of the significant assets other than trading stock;
- The significant assets transferred continue to be active assets; and
- There is no material or significant private use of the significant assets transferred.

Proving that ultimate economic ownership has not changed would usually be reasonably straight forward, however it can be complicated when a discretionary trust is one of the parties to the transaction.

We mention these changes because with specialist legal advice it is possible that there may be Asset Protection possibilities if you operate in a high-risk industry and there is the possibility of litigation further on down the line.

THE CLAWBACK PROVISIONS

A lack of planning may prove fatal due largely 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 5 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 market value of the property.

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

  (a) a payment of tax payable under a law of the Commonwealth or of 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 4 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 2 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 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 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 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 a 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 fully understand the tricks, traps and pitfalls. All too often bankrupts lose family assets due to a lack of understanding or by way of oversight or a lack of care.

It is necessary to understand which assets in a bankruptcy 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 net worth of the entity 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 was vested in, a bankrupt at the commencement of the bankruptcy, or has been acquired or is acquired by him or her, or has devolved or devolves on him or her, after the commencement of the bankruptcy and before his or her 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 his or her own benefit at the commencement of the bankruptcy or at any time after the commencement of the bankruptcy and before his or her 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 difficult 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 quite 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 trade that the bankrupt uses in earning income by personal exertion—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.

A 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.*

A 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 factor 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 trade (see above) act subject to statutory value thresholds, which is 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 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.

INSOLVENCY LAW REFORM PROCESS CONTINUES AS GOVERNMENT RELEASE PROPOSALS PAPER

The Federal Government released its "National Innovation and Science Agenda" ("Agenda") on 7 December 2015, outlining its intention to make three significant reforms to Australia's insolvency laws.

The recommendations of the Productivity Commission ("Commission") in its report, "Business Set-Up, Transfer and Closure" ("Report") also released on 7 December 2015 was fully adopted.

- Reduce the default bankruptcy period for individuals from three years to one year;
- Introduce a "safe harbour" providing directors with immunity from personal liability for insolvent trading under section 588G of the Corporations Act 2001 (Cth) ("Act") during the implementation of a restructuring plan; and
- Preventing the enforcement of "ipso facto" contractual clauses during a restructuring attempt.

The feedback to the changes has been largely positive due to long held concern that directors have cautiously appointed voluntary administrators to companies at the first sign of financial trouble as a defence to the insolvent trading provisions in sections 588H (5) and 588H(6) of the Act.

Arguably this action has triggered the destruction of companies' enterprise value as core creditors and suppliers have terminated their contracts, relying on ipso factor clauses that apply when companies experience an "insolvency event". Frequently those companies have been liquidated with employees and other unsecured creditors facing significant losses.

To continue the reforms, the Government released a proposals paper, "Improving Bankruptcy and Insolvency Laws" ("Proposals Paper") on 29 April 2016 for public consultation.

Reduced Bankruptcy Period

This proposes reducing bankruptcy period (along with relevant restrictions that apply during bankruptcy such as credit and travel restrictions) to one year to "encourage entrepreneurial endeavour and reduce associated stigma".

This reduced default bankruptcy period, which mirrors the default period in the United Kingdom recognises that bankruptcy is not necessarily the consequence of any "misconduct" by an individual and that genuine business failure is an ordinary part of a well-functioning economy. It is considered by many that the current framework entrenches a "fear of failure" that has inhibited the development of an entrepreneurial culture of the kind seen in the United States.

However, it is proposed that the default bankruptcy period that the new Government continues to progress the insolvency reforms by preparing draft legislation and actively engaging with stakeholders in what would appear to be the most significant adjustment to Australia's insolvency landscape in the last decade.

We mention in passing that the proposals paper:

- Outlines two options for implementing a safe harbour from the insolvent trading provisions (s588)
- Discussion of these and the IPSO Facto Contractual Clauses (which allow a supplier or financier to terminate a contract with a company on an insolvency event) are not appropriate at this time given the political uncertainty facing us.

Significantly in the report the Commission recommended against the wholesale adoption of the Chapter 11 (America model) restructuring arrangement in Australia citing cultural differences and excessive costs.

UPDATE - 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 they develop and implement 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 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.

This now 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 companies into voluntary administration or liquidation in order 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 be able to 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
- they have developed a course of action has been framed which is 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 plan from a qualified advisor such as an accountant or lawyer and their opinion as to 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).

Clearly those who have not kept proper records and/or are seeking to not pay employee entitlements as well as not pay money they are holding in trust for the ATO (PAYG and GST), cannot enter 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.

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 automatic discharge from bankruptcy from 3 years to 1 year after the filing of a statement of affairs by the bankrupt.

However, bankrupt remains subject to the income contribution regime until the later of 3 years from the day they became bankrupt or when they are discharged.

It’s possible 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 3 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 possibility of the Trustee objecting to a bankrupt’s discharge?

In the event the legislation is passes, this would not be first time that 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.

STRENGTHENING COMPANY AND DIRECTORS' OBLIGATIONS

Director's Penalty Notices –Legislation

This legislation was passed by the Government in July 2012.

- In addition to liability for PAYG withholding amounts, directors are personally liable for their company's unpaid superannuation guarantee charge.
- 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 charge.
- The Commissioner may also serve a copy of a director penalty notice on the director at his or her tax agent's address.
- Where 3 months has 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 3 months after they become a director of a company, rather than 3 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 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 who are 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 company director:

- Ensure that, as part of your due diligence that you cover the company's 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 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.

ADDITIONAL EXPOSURES FOR DIRECTORS, TWO CASES – CREDITORS AND FINANCIERS

Don't 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 decision of the Western Australian Supreme Court 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, at a price of $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 recent and 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, aimed specifically 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 also applies to 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 this unreasonableness is established, the liquidator has a range of options under section 588FF to recover the money or property transferred, or to 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 the decision will be welcomed by liquidators, 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 debt of a third party.

If a transaction is an unreasonable director-related transaction, there is a four-year relation back period and 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 25 years there has been a major shift as most small businesses have moved to completely computerise their records.

For business owners (typically those in middle age or older) who don't know their way about the ledgers of say QuickBooks or MYOB this could be dangerous.

Formerly such business owners would carefully scrutinise their manual cash books 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 don't need accounting expertise to identify false transactions as you will generally know what is and isn't going on in your business.

If you can't do this at the very least request hard copies of monthly ledgers, scrutinise these and ask questions. This puts your staff on notice that you are checking things.

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

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.

56 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 Australian 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 in particular steal due to pressing financial needs. Let's 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 in addition to the bookkeeper reconciles amounts owing with 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.

The majority of fraud can be prevented with the right 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 loss that is possible 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 heavy involved in the business,
- Such people tend to develop faith in the bookkeeper relying on them because they can't stand paper work,
- Whilst the bookkeeper may be keeping the office organised and tidy, they may also be robbing the owner's blind!
- This is because the owners 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 don't 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 this 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 important 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 a range of 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
- belief that you 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 contemporaneous recording of the transaction. In a small business this may not be practicable, but you should be aware of "best practice" because the cost of complacency could be your business survival.

At least three people are involved in the preparation, authorisation and processing of any payment; each person will only handle the transaction once; the detail 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 at that time.

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 a 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 pursuant to 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 indemnified by the directors for certain taxation liabilities of the company.

There are also Common Law and Contractual duties owed by directors that are 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 a directors and the company. A liquidator is able to bring proceedings for breach by a director of a duty owed to the company that but for the insolvency of the company, would otherwise be exercisable by the company.

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 of course the directors are covered by D & O insurance giving the practitioner access to the funds of an insurance company.

There are however a number of standard exclusions from D&O policies which significantly restrict the amount of ambit of their operations. These include:

- **prospectus-type liability exclusion** which will often be of importance to directors of companies who propose to embark on a public offering;
- **professional indemnity exclusion** which excludes cover for claims alleging a breach of duty other than the professional duties owed by a director;
- **insured versus insured exclusion** which 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 normally include an exclusion to extend cover to claims brought in the name of the company 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 provide that a company must not pay an insurance premium of the company against a liability arising out of conduct involving a willful breach of duty. So as long as the D & O policy excludes such claims from its ambit a company is able to 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 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 had knowledge of the insolvency of their company or themselves.
3. Directors should avoid having control of the entities that their assets are held in. 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 rather 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. Obviously, 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. This mechanism also protects your property in the event you die, and your spouse commences a relationship with someone else. 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 over the long term provided one of the best returns when 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 in the event of your bankruptcy your inheritance will form part of your divisible assets amongst your creditors. 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 on the event of your insolvency. Again, in these instances a Bloodline Testamentary Trust is a useful 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 and accordingly being prudent about ones 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. Directors can, if they structure their affairs properly avoid losing all their assets if there is a commercial disaster. Although the above strategies protect directors in case of 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 a 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 in 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 which 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 that allow a trustee in bankruptcy to access the family home on behalf of creditors even if only one spouse goes bankrupt, and regardless of whose name the property is in.

Anyone in this situation should review existing structures.

The period of time 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 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; the husband used or at least obtained an indirect financial benefit from the property; or the value of the wife's interest in the property has increased by the amount by which the mortgage has decreased and the amount by which the property has increased in value.

Alternatively, if the property was bought using resources provided by the spouse being bankrupted, then, under the new section 139DA, 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's not all. A recent High Court decision has taken the view that the family home is owned by the two spouses – 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.

The Cummins case in particular concerned a bankrupt barrister who didn't 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 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."

The good news is that in this case, 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 with that 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, but 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 in particular 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 2 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 Cummins, 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. This was to defeat the wife's argument that various amounts which she alleged had been borrowed against the property to lend to the husband's business ought not to be taken into account.

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 there was no evidence to rebut the presumption or 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 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 and so the doctrine of exoneration was not relevant. However, if his Honour's statement is correct, Bankruptcy Trustees will be able to recover the bankrupt's interest in 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 also confirms the Court's willingness to follow High Court's lead and ignore the specific contributions of husband and wife to the purchase of matrimonial property in favor 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.

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 provision 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 that 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.

All of us 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 an amount of money to the owner and takes a secured mortgage over the property.

As an example, assume that Tony holds 100% of an investment property and the current value of the home 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. In the event the property is currently 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 full value of the property is protected by registered mortgages.

The gift and subsequent loan would ideally involve physical transfer of funds, by way of electronic funds transfer. If this is not possible there are other alternatives that 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. This includes are 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 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 normal Bankruptcy “clawback” provisions apply to arrangements such as this – see pages 36 & 37.

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 in the context of asset planning within a family group.

This will affect 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 main 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 assets of the company. A lawyer can prepare the documentation and ensure the change is registered with A.S.I.C.

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 it is registered outside the 45-day period, unless it is registered more than 6 months before an appointment. It is possible for a lender to apply to have the Court extend the 45-day period, but a creditor will need a very good 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 a security on that property as against the liquidator, the administrator of the company, or the deed's administrator 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 6 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 property of a company should the loan fall into default. It is a form of insurance. If lenders fail to correctly register a charge, 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, and 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 and 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 holder of the lien 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, and not just sums payable in respect of 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 that are incurred in respect of the hostage goods. An example is a 'workers lien' in respect of 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 in order for that party to work on or improve the goods, the owner may prevent a lien from arising by ensuring that the obligation to pay for the improvements arises after the goods are returned.
- The High Court has confirmed that gaining weight can be considered an 'improvement' - don't let anyone tell you differently.

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 rental property can be registered – see above commentary.

It is wise to review inter-entity loans in the context of trading conditions on a regular basis.

THE PERILS OF LOAN ACCOUNTS

The three preceding topics lead on.

Liquidators reviewing the financial accounts of the company 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 about 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 which is 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 actually accounted for as 'wages'. While this may increase PAYG tax and reporting implications, it will not only more accurately reflect the amount being drawn by the director in benefits, but also avoids the building up of a sizeable loan account.

Furthermore, it will avoid having to argue 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 how importance of proper management of loan accounts.

It is true that directors' loan accounts often arise as a consequence of excessive drawings and/or not paying the business owner a consistent and realistic wage.

Sadly, this mismanagement sometimes extends to staff with the business owner sometimes falsely treating employees as "contractors".

We have outlined above 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 being 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 then he/she is 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 isn't 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 40 years' experience and 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 various managers

All these things are functions which failed businesses have usually bypassed. Not all businesses with budgets prosper but most businesses without budgets will fail.

Below are the elements of a good business budget.

Soundly based budgeting principles:

- realistically reflects external and internal factors...it's 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 a good time to prepare a budget.

We lead on from above with four case studies:

Different Business Structures – A Cautionary Tale

People starting out in business often don't 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 structure to operate a business through, 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 Tax Essentials we sometimes see the good and bad of business structures and what structures may have been better in hindsight. Here are a few useful 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 couldn't be sold its doors closed.

As the husband and wife were operating a partnership, they were jointly and severally liable for the debts of the business.

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, it is likely that their personal exposure would have been reduced by operating the business through a corporate structure. Although, the business could have been operated by the wife 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 which 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 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 of 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 in respect of an accumulated PAYG withholding debt.

The directors were forced to put the company into liquidation or voluntary administration to avoid the ATO pursing them personally for the amounts under the DPNs. The ATO debt 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 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 incorporation of a new corporate trustee was clearly 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. In doing so, they set up a new company to purchase and operate the bar which started to lose money.

The losses were funded by the profits from the electrical business. 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 were able to 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 the separation of businesses in 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, 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 money you are holding on trust for the ATO and/or 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 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 and would like to 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 current structure? Well Andrew is the individual sole shareholder of a company that has 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 27.5% 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 in time the business expands an 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 environment laws et al.

Andrew as an individual may not be completely safe from litigation but the bulk of his future assets, i.e. shares, investments and boat will be at least safe in an asset protection trust. This trust must not incur any unnecessary risk or engage in any commercial activity.

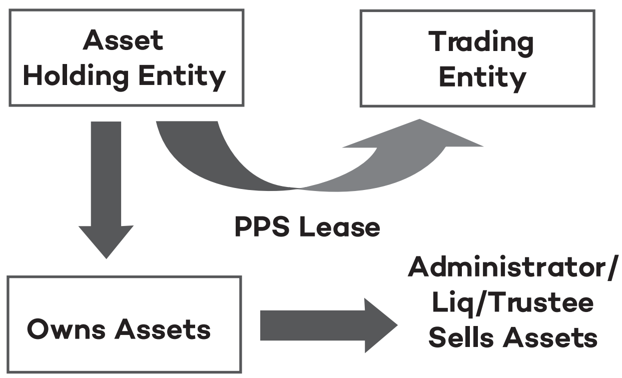
If there is any risk perceived from owning a boat regarding third party claims, then of course a separate entity would own the boat and in fact we would recommend this.

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

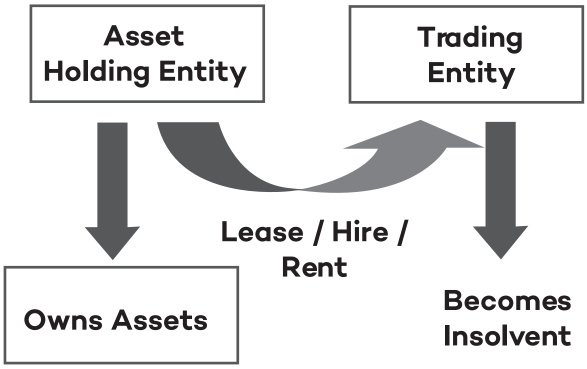
The Personal Property Securities Act ("PPS Act") commenced on 30 January 2012. The potential impact the PPS Act has on commonly used asset protection structures is outlined below.

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 to the "Trading Entity" which is carrying 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 in the event the Trading Entity becomes insolvent as ownership vests with the Asset Holding Entity, as set out below.



Under the PPS Act, such arrangements are deemed security interests (defined as a PPS lease) and require perfection under the PPS Act, 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 grantors 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, and 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 changed because of the vesting provisions on insolvency (Section 267) and the priority rules for competing security interests (Section 55(3)). Based on these changes the above asset protection structures must be documented in writing and perfected by registration on the PPS register. 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 or the bankrupt estate and the asset protection structure will provide no protection to such assets. The assets would also be lost to a secured creditor who has a competing security interest (such as a bank), provided that 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 which are in existence prior to registration commencement time; and
2. arrangements entered into post registration commencement time 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.

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. That is 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 fundamental shift in protection and the fallouts of ineffective registration is 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 pursuant 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 there was 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 useful 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 the price for those supplies in priority over the principal’s other creditors.

But PPSI registration will only have this effect if it is done on time and properly. This requires a practical understanding of the PPS 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 fulfill all these roles always in a tax effective way.

For this reason, analysis of your business structures should be undertaken on a regular basis, 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 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 a 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 have structured their assets in a way such that one party, who has a low risk profile, is the ‘asset holder’ it is essential to ensure that his or her will is drafted in such a way that the prior good 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 who has control of assets. Consider, a wife holding the matrimonial assets wholly in her own name. If 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, 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 needs of the husband 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 is not the will of the 'high risk' person but rather the will of the other party who holds the valuable assets.

The 'high risk' person will generally not welcome the fact that he or she has an individual expectancy under the will of another person – typically their spouse or parents. Their estate planning exercise might be rendered ineffective if a person holding assets dies at a time when a claim is pending against another person who is beneficiary of the estate.

Again, consider instead whether assets should be transferred to a discretionary trust, or retained in a testamentary discretionary trust established under the will, with the at-risk party being 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 easily by diverting of 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.
- Asset protection for the beneficiary of a deceased estate at risk from creditors' claims.
- Asset protection for vulnerable beneficiaries i.e. those with substance abuse issues or gambling problems.

Always ensure the TT is properly 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 they are now held by Peter, a high-risk person. Now 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 is 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.

SOLE DIRECTOR AND SHAREHOLDER BECOMES BANKRUPT

Sole director and shareholder companies have been allowed since the mid 90's. 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 on becoming a bankrupt a person is automatically disqualified from "managing a corporation". Further, section 201F (3) strongly suggests that "disqualified" means automatically 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 a discretionary power to place a company into liquidation when certain 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 key 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 has to be clear... address the matter immediately and seek good 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 there are arrangements that can be made once the issue is addresses. 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 is ran a month-long campaign, with other Commonwealth, state and territory agencies, to help consumers understand that by using credit repair and debt management firms they may end up paying high fees.

Consumers should be aware these companies often fail to fix credit and debt issues, which can leave 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

On 14.2.2018, the Federal Government introduced 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 process of bankruptcy 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 (from $111,675.20 to $223,350.40) in recognition of the growing value of Australia's property market, opening up 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; tougher penalties for wrongdoing (such as a new three-month period of imprisonment if an administrator offers a creditor money with a view to influencing their vote) and granting the Inspector-General in Bankruptcy additional investigative powers to address misconduct.
- Ensuring greater professionalism into 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 proposed reforms will commence six months after the Bill passes Parliament, giving the debt agreement industry time to prepare for the reforms.

This legislation will make 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 key 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;

   - Judgments and/or Warrants issued against the business;

   - Winding up/Bankruptcy notices?........................ ◯ 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/pr the A.T.O.?........................ ◯ 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.

Your Notes

DISCLAIMER

This information, statements 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 preperation of the 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 information set out in this publication and its accuracy in relation to their own particular circumstances.

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