



March 2010 Bulletin

- **Treasury Discussion paper**
- **Recent cases and rulings**
- **New legislation**

For your interest, this month the following developments have occurred, including recent case judgments, draft Bills, legislation, and a Treasury discussion paper on changes to insolvent trading rules.

Treasury Announced Insolvent Trading Discussion Paper

In response to debate in the community about effectiveness of Australia's insolvent trading laws, the Treasury has released a discussion paper outlining possible options for reform to the laws in relation to business rescue outside of external administration.

Treasury argue that informal work-outs play an important role in preserving a troubled business and protecting the interests of its creditors, shareholders, employees. Concerns have been raised that the laws directed at preventing businesses from trading while insolvent may negatively impact on genuine work-out attempts; in particular, where restrictions on the availability of credit impede the ability of businesses to temporarily

maintain solvency while work-outs are attempted.

The paper canvasses three possible options for reform: adopt a modified business judgement rule in respect of a director's duty to avoid insolvent trading; adopt a mechanism for invoking a moratorium from the insolvent trading prohibition while work-outs are attempted; or maintain the status quo.

The first option would involve an amendment to the business judgment rule, so that a director's duty not to trade whilst insolvent would be considered to be satisfied if, in addition to the requirements in the business judgement rule in section 180 of the *Corporations Act 2001*: 1) the financial accounts and records of the company presented a true and fair picture of the company's financial circumstances; 2) the director was informed by restructuring advice from an appropriately experienced and qualified professional with access to those accounts and records, as to the feasibility of and means for ensuring that the company remained solvent or that it was returned to a state of solvency within a reasonable period of time; 3) it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as of members, were best served by pursuing restructuring; and 4) the restructuring was diligently pursued by the director.

Under the second option proposed by the paper, directors would be able to openly and expressly invoke a moratorium from the duty not to trade whilst

insolvent for the purpose of attempting a reorganisation of the company outside of external administration. The moratorium would apply for a limited period and would be subject to termination by creditors. It is still yet to be seen which way the Treasury will choose to move.

The full paper can be viewed at the Treasury website.

Federal Court clarified 'residential premises' and input tax credits

Sunchen Pty Ltd (ATF the Sunchen Family Trust) v FCT [2010] FCA 21 (29 January 2010)

In a case concerning a residential dwelling that had development approval, the Federal Court has confirmed that the taxpayer purchaser was not entitled to an input tax credit for the acquisition of the property.

The taxpayer, a trading trust which carried on business as a property developer, argued that the test to determine whether the property was residential premises 'to be used predominantly for residential accommodation' should be subjective in accordance with *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* 2006 ATC 4160.

The court upheld the use of *Toyama*, which dictates that the most important factor in predicting the future use of residential premises is the intention of the purchaser. Further, the court also found that it was legitimate to look at what the taxpayer did after completion to test whether the asserted intention existed.

Section 9-80 treatment of 'supply' unresolved

Luxottica Retail Australia Pty Ltd v FCT [2010] AATA 22 (15 January 2010)

This recent decision of the AAT considers s9-80 of the A New Tax System (Goods and Services Tax) Act 1999 dealing with 'supply'.

The taxpayer was a retailer of spectacles that offered a discount on frames but not the lenses acquired with the frames. The supply of the frames attracted GST but the supply of the lenses was GST-free. **The central issue was how the discount should be treated for GST purposes.**

The AAT acknowledged a problem with s9-80 in that this single actual supply (of a pair of spectacles) must be partly a taxable supply and partly a GST-free supply, but still only constitute one supply. The AAT took the view of the GST as 'practical business tax' to resolve the issue at hand. The AAT declined to give a detailed analysis of when s9-80 - a provision described as "fiendish" (*ETO Pty Ltd v Idameneo (No 123) Pty Ltd* [2004] NSWCA 368)- should apply.

The AAT ruled in favour of the taxpayer. The FCT will appeal to the Federal Court.

Court found no 'concession' for marina

Meridien Marinas Horizon Shores Pty Ltd v FCT [2009] FCA 1594 (24 December 2009)

This case concerned whether a marina operator was engaged in a taxable supply of commercial accommodation to the satisfaction

of Division 87 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (the "GST Act").

The taxpayer operates a marina, moorings at which are sold in up-front for 20 year leases. **The Federal Court was required to determine whether Division 87 of the GST Act applies** to each pre-payment (including outgoings, levies or maintenance fees) with the result that s 87-5 of the GST Act reduces the value of the supply by 50% of the price that would otherwise prevail, thus reducing the GST payable on the supply. The application of Division 87 to a relevant supply is said to bring about what has been described as "concessional" GST treatment.

The court found against the applicant taxpayer that it did not supply 'commercial accommodation' for the purposes of the Act.

New Legislation to deal with no-will estates

Succession Amendment (Intestacy) Act 2009 (NSW)

A new Act has come into force which amends the *Succession Act 2006* and the *Probate and Administration Act 1898* to revise and re-state the rules for distribution on intestacy; and for other purposes.

Intestacy is the default method of distributing someone's estate in the event of a person not having a valid will in place. Previously, estates of people who died intestate were distributed between spouses and their children. However, under the new law, children will not be automatically included in the inheritance unless they are from a

previous relationship. The changes reflect a Law Reform Commission survey which found that 75% of people who have a will leave everything to their spouse. However, fewer than half of those who had children from a previous relationship left everything in their will to their spouse.

On introducing the law to parliament in March 2009, NSW Attorney-General John Hatzistergos said the new laws made the administration of an estate much simpler in the case of a person without a will who died leaving a spouse or partner and children of the relationship.

The new law will widen the pool of people who can inherit in NSW and recognises that some other jurisdictions in Australia include first cousins in the distribution list under intestacy laws.

Cousins will now be recognised as eligible heirs to the estates of people who die intestate. The entitlements of first cousins would come in order of importance after spouses and children; parents; siblings; grandparents; aunts and uncles. Estates of people in these circumstances would have previously gone to the Crown. The NSW Trustee and Guardians 2009 Omnibus Newspan Survey showed 46 per cent of people do not have a will. Making a will remains the only way of guaranteeing that an estate is distributed according to your wishes.

The Act can be found at www.legislation.nsw.gov.au

Proposed Bill will change financial reporting practices Corporations Amendment (Corporations Reporting Reform) Bill 2010 (Draft)

The Corporations Amendment (Corporate Reporting Reform) Bill will change the way companies prepare their financial reports in the future.

For companies limited by guarantee, this will mean the introduction of a three tiered differential reporting framework, exempting small companies limited by guarantee from reporting and auditing requirements and providing other companies limited by guarantee with streamlined assurance requirements and simplified disclosures in the director's report.

For parent entity financial statements, where consolidated accounts are required, the parent entity will not have to publish separate accounts.

Other changes will be made to the payment of dividends. Currently, dividends can be paid out of profits, but this can lead to uncertainty. The profits test will be repealed and replaced with a more flexible

requirement that allows a company to pay dividends if the company's assets exceed its liabilities and the excess is sufficient for the payment of the dividend. Also, if it is fair and reasonable to the company's shareholders as a whole, and it does not materially prejudice the company's ability to pay its creditors.

The draft Bill will also change the law in respect of disclosure of contingent liabilities, in particular liabilities which can arise from current or pending litigation.

Following a decision of the Court of Appeal, letters containing a solicitor's assessment of litigation obtained by an auditor as appropriate audit evidence are not subject to legal professional privilege. This draft proposes to protect such letters from disclosure to other persons or a court, subject to certain exceptions.

Finally, cancelling paid-up capital that is lost or not represented by available assets in the company will be addressed. Under the Bill, cancelling capital in this way will be required to comply with accounting standards.

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