Client Information Bulletin

BLAZE ACUMEN
CHARTERED ACCOUNTANTS

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Contents

CHARTERED ACCOUNTANTS
AUSTRALIA • NEW ZEALAND

SMSF – limited recourse borrowing

Borrowings of any sort within a Self-Managed Superannuation Fund (SMSF) are generally explicitly prohibited. Funds can however borrow in order to purchase an asset. In order to do so, certain criteria must be met:

- Section 67A of the *Superannuation Industry (Supervision) Act 1993* (Cwlth) permits a borrowing arrangement if the money borrowed is applied to a 'single acquirable asset' and the asset is held in a holding trust (legal owner).

  Under such arrangements the SMSF trustee acquires a beneficial interest in the asset and the lender's right of recourse in the default is limited to the acquirable asset held in a building trust.
- Money borrowed under limited recourse borrowing arrangements may be applied not only to acquire the single acquirable asset, but also when carrying out repairs and maintenance to the asset at the time of acquisition or at a later time.
- No amount borrowed by the SMSF trustee may be applied to improve the single acquirable asset. A breach of this rule may lead to a contravention.

  It is imperative to distinguish between maintaining, repairing and improving.

  The ATO has also recently issued Interpretative Decisions ATO ID 2014/39 and ATO ID 2014/40 in relation to borrowings by SMSF's to acquire listed shares and real property. The ATO's view is that such borrowings must be on an arm's length basis in relation to the interest rate and the borrowing amount (loan value ratio).

For more information please contact us.

Christmas benefits

With the holiday season approaching, staff and client functions and gift giving are quite common. If you are considering Christmas presents for your staff or clients ensure the gifts are below $300 per person - the threshold for Fringe Benefits Tax for minor benefits. Anything above $300 per person will be subject to Fringe Benefits Tax at a rate of 47%.

Alternatively, if you intend to hold a Christmas party you must keep the cost of your celebrations below $300 per person to treat it as an FBT exempt minor benefit (please note other conditions also apply).

Please note, the $300 threshold includes all costs associated with the event such as meals, drinks and entertainment. If you send your employees home by taxi, travel to and from the event will also be factored into the $300 threshold.

If your Christmas party is slightly more extravagant and costs above $300 per person you will pay FBT but a deduction can be claimed for the cost of the event.

For employers that chose to be more altruistic, Christmas can be a time of charitable giving. While it may be considered unconventional, making a donation can generate goodwill amongst employees, particular where they are given the opportunity to choose their charity. From a tax perspective it is the safest way to ensure that you and your business can claim a deduction for your 'Christmas charity' though it is important to

make certain the charity is registered to receive donations that are tax deductible.

If you are planning to provide your staff with cash bonuses rather than a gift voucher remember that the cash will be taxed in the same way as wages and salaries; a PAYG withholding obligation will be triggered. The Australian Taxation Office generally views bonuses as ordinary earnings. This means the cash bonus will be subject to Superannuation Guarantee provisions too (an extra expense).

Travel allowance deductions

Last year an Administrative Appeals Tribunal (AAT) decision, *Gleeson and Commissioner of Taxation* [2013] AATA 920*,* was issued regarding a substantiation exemption for expenses incurred by a taxpayer while travelling overnight for work purposes.

The AAT found that the taxpayer had incurred food and drink expenses while on trips away from home and had received a bona fide travel allowance to cover the expense. The taxpayer was therefore entitled to rely on the exemption from the substantiation provision when claiming deductions.

The Australian Taxation Office has now issued a decision impact statement which reminds taxpayers that this decision was based on the facts of the case and does not present any new principal of law.

Where an individual receives a bona fide travel allowance and relies on the Commissioner's reasonable amounts for claiming travel expenses, the taxpayer is still expected to be able to demonstrate that expenses have actually been incurred.

Unreasonable director related transactions

Liquidators have a variety of voidable transaction provisions available under the *Corporations Act 2001* (Cwlth), which allow them to recover certain transactions occurring prior to their appointment. These provisions include the ability to recover an 'unreasonable director related transaction'.

Section 588FDA of the Act was implemented in response to public concern about unreasonable bonuses received by directors of failed companies. The provision allows a liquidator to recover transactions entered into by directors or their close associates, which were unreasonable and to the company's detriment.

A 'transaction' in this instance is an unreasonable director related transaction if it has three elements.

Element 1

It must be a payment, transfer or conveyance or other disposition of the company's property, or an issue of securities. Alternatively it may involve incurring the obligation to make such a payment, disposition or issue.

The transaction must be entered into by the company during the four years ending on the 'relation back day'. For a voluntary liquidation this is the winding up date. Importantly, the liquidator is not required to prove that the company was insolvent at the date of the transaction.

Element 2

The payment or disposition must be made to a director of the company, a close associate of a director or a person on behalf of, or for the benefit of the director.

Element 3

It should be expected that a reasonable person in the company's circumstances would not have entered the transaction when taking into account the benefits and detriments to the company and the respective benefits to other parties of entering into the transaction and any other relevant matter.

In 2013, the court held that a liquidator must prove a director received a direct benefit from the transaction and found the section did not apply where the person that received the benefit was a company of which the director benefited as a shareholder only. However, a decision delivered by the court earlier this year broadened the scope of the 'unreasonable director related transactions' by defining what is considered a benefit. The court noted that, "*…According to ordinary acceptation, 'benefit' includes both direct and indirect benefits and prima facie, that accords with the apparent objective of the section. If so, why should the notion of benefit be confined to direct benefit for the purposes of the section?*"

Consequently, it appears that any benefit containing these elements could be considered an unreasonable director related transaction for the purpose of this section.

Claims of contingent creditors in external administrations

Contingent, by definition, is something that only occurs or exists if certain criteria are met. Accordingly, a contingent creditor is a creditor who, as at the date of the appointment of an external administrator, does not have a debt, however, should certain criteria of a pre-appointment event or agreement be met in the future, a debt or claim will come into existence.

There are two main uses for proofs of debt or claim in

external administrations. The first is to quantify a creditor's debt for the purpose of voting on resolutions considered at a meeting of an insolvent entity's creditors. The second is to provide details and evidence to support a creditor's debt or claim, sufficient to enable the external administrator to admit the debt or claim for the purposes of paying a dividend.

Voting at meetings

The *Corporations Regulations* 2001 provide various requirements which must be met when convening and conducting a meeting of creditors of an insolvent entity.

Regulation 5.6.23 addresses which creditors may vote on the resolutions proposed - 'A creditor must not vote in respect of…(b) a contingent debt…unless a just estimate of its value has been made.'

An external administrator does not, however, have to automatically allow the creditor to vote for the amount estimated. The chairperson of the meeting, usually the external administrator, has the power to admit or reject a claim for voting purposes. Accordingly, should the creditor not provide sufficient details and evidence to support the claim, including the estimated value, the proof may be rejected for voting purposes. The chairperson's decision may be appealed against in the courts within 10 days after the decision has been made.

If the chairperson has any doubt about admitting or rejecting a proof of debt or claim, the regulations require that the chairperson allow the creditor to vote, however, the proof of debt or claim must be marked as having been objected to.

Any decision made regarding the admission or rejection of a creditor's proof of debt or claim is not binding when it comes to the payment of a dividend.

Admission for dividend purposes

Pursuant to Regulation 5.6.63 a creditor's debt or claim must be admitted on or before the date on which a dividend is paid if it is to participate in the dividend.

Similar to an adjudication for voting purposes, an estimate as to the value of the creditor's contingent debt or claim must be made. However the external administrator must make the estimate, not the creditor.

Given that contingent debts or claims can be complex, the quantification of the contingent debt or claim can be referred to the court.

It is then up to the court to either quantify the debt or claim, or provide the external administrator with a methodology to determine a value.

A person who is aggrieved by the decision of the external administrator or the external administrator's application of the court ordered methodology is able to appeal against the decision within 21 days of becoming aware of the determination, or as extended by the court.

Consequently, even though a debt or claim may not exist at the date of the appointment of an external administrator, any potential debt or claim, provided that they are based on conditions instigated prior to the appointment, are required by statute to be dealt with, just as debts or claims which did exist at the appointment must be dealt with. In fact, Section 553 of the Act provides confirmation of this as it states "in every winding up, all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), are admissible to proof against the company."

Claims of contingent creditors can be quite complex. For more information please contact us.

Application for security for costs against a liquidator

Where a company in liquidation commences proceedings against a defendant, each party will inevitably incur legal fees and disbursements in order to prosecute and defend the proceedings. A liquidator would ordinarily engage solicitors and barristers on the basis that their costs would only be paid on a successful result. In most cases, once a judgment regarding the proceedings is determined, orders are subsequently made for the unsuccessful party to pay the costs of the successful party. However, in some situations, despite the cost orders being made, the unsuccessful party may be unable to satisfy the costs incurred. This is a likely scenario for liquidators if they are unsuccessful in proceedings as companies in liquidation are often without funds.

In order to avoid the unsuccessful party being unable to satisfy any order for costs, a defendant may seek an order for the party commencing proceedings to provide security for costs. The main purpose of the order is to ensure any unsuccessful proceedings do not disadvantage the defendant.

It is important to note however, that a liquidator does not always need to provide security for costs when bringing proceedings against a defendant. The court may consider a number of factors when determining whether to order security for costs. Some factors which are particularly relevant for liquidators include:

- the prospects of success or merits of the proceedings brought by the liquidator

- the genuineness of the proceedings brought by the liquidator
- whether the administration is without funds and whether this is attributable to the defendant
- the reasons for the proceedings and the conduct of the proceedings
- where the effect of an order for security would be to stifle the liquidator's claim
- whether the proceedings involve a matter of public importance
- the overall costs of the proceedings
- proportionality of the security sought to the importance and complexity of the issues
- the timing of the application for security.

In the case *Golden Mile Property Investments Pty Ltd (In Liquidation) v Cudgegong Australia Pty Ltd* [2014] NSWCA 224, the Supreme Court of New South Wales – Court of Appeals decided against an order for security of costs to be paid by the liquidator. Some of the factors that were considered in making the decision were as follows:

- the strength and genuineness of Golden Mile's proceedings
- whether Golden Mile's inability to provide security for costs was caused by the actions of Cudegong Australia
- whether security for costs would stultify the litigation.

This decision demonstrates that the court will consider the unique facts of each proceeding when exercising its discretion in making an order for security for costs. An application for security of costs against a liquidator that has limited or no funds may not be successful.

Business management for Christmas 2014

Christmas can present some real challenges for small businesses. At this time of year it is not uncommon to find some debtors postponing payments until the New Year. To avoid this, it is essential to place a strong focus on debtor collection before Christmas to ensure there is cash flow for January and February.

Christmas is also a good time to review employee leave entitlements. Small businesses need to be firm about minimising accrued employee leave liability entitlements. While small businesses tend to be more willing to accommodate staff requirements they can become a significant liability and a future cost. As such, it is best to deal with leave on an ongoing basis. It is also important that businesses inform employees of when it is suitable to take leave – whether it be Christmas, Easter or another time specific to the business.

Stock management is also critical at this time of year. Some retail businesses may have a clear focus on minimising retail stock holdings by Christmas Eve. In other instances, businesses may be best to stock up in December so they can recommence production in January rather than waiting for stock deliveries on their return.

In the lead up to Christmas ensure that your business affairs are in order.

Is that worker really a contractor?

Distinguishing between employees and contractors is not just a HR issue. There are tax consequences too.

In general terms, if a worker is an employee:

- PAYG withholding applies to salary
- Fringe Benefits Tax applies to non-cash benefits
- the employer must make superannuation contributions
- there could be state payroll tax.

A 'genuine' contactor on the other hand should have an Australian Business Number (ABN) which raises other issues such as Goods and Services Tax.

The tax and superannuation guarantee laws are structured in a way that, even if a worker has an ABN, the payer (employer) is still obliged to determine whether the worker is in fact a 'genuine' contractor or really an employee.

There have been many court cases on the employee-contractor distinction, and these decisions have determined numerous 'tests'.

If you use contract labour in your business, it is worth implementing a checklist approach for use at hiring time which reflects these tests. That way, you can demonstrate to the ATO and others that your business has done its best to comply with a very difficult area of tax law.

For assistance in designing a checklist please contact us.