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TAX matters

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Director Penalty Notices – the quick or the dead

In these uncertain economic times it is not only commercial creditors who get nervous about unpaid monies. The ATO also gets concerned.

Director penalty notices are an extremely powerful and effective debt collection tool available only to the Australian Taxation Office (ATO). They allow the ATO to impose penalties equal to unpaid tax liabilities on company directors without the delay or expense of taking legal action. For this reason it is essential that company directors act promptly if they

receive a director penalty notice. However whilst it is easy to conclude that company directors must act quickly if they receive a notice, they must choose their course of action carefully.

How the notices work

If a company falls behind in its payment of tax liabilities (e.g. PAYG) the ATO can direct a penalty notice to any of the directors. Once the notice is received the company directors have **14 days** to implement one of four alternatives:

- ◆ Pay the company debt in full;
- ◆ Conclude an instalment arrangement with the ATO;
- ◆ Ensure that the company is wound up; or
- ◆ Place the company into administration.

If one of the above four outcomes is not achieved within the 14 day period then recovery action may be taken against the directors for the amount set forth in the notice.

Pay the Debt in full

Ensuring that the company pays the debt is the most obvious way of dealing with the director penalty notice, but depending on the circumstances, it may not be the best alternative.

If the company is later wound up despite the best endeavours of directors then the liquidator will scrutinise any payments to creditors and attempt to claw back any potential unfair preferences. Unfair preference payments are governed by the Corporations Act. Briefly they are transactions that provide a creditor with part or full payment that is not available to all other creditors of the company and they may be recovered or called back by a liquidator. If the liquidator is able to recover unfair preference payments paid to the ATO then the Corporations Act allows the ATO to seek reimbursement from the directors of the company unless the directors can establish one of the statutory defences.

Conclude an instalment arrangement

Concluding an instalment arrangement with the ATO that

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will resolve the question is preferable, to a point.

However if the company later breaches the arrangement then any one who acted as a director between the time when the agreement was reached and the date it was breached can be personally liable.

For that reason instalment arrangements are only appropriate where the directors have a high level of confidence that the company will fully comply with the agreement.

If this option is under consideration one must bear in mind that the payment arrangement must be in place before the end of the 14 day period. Merely commencing a negotiation is not enough.

Place the company into liquidation or voluntary administration

If an instalment arrangement or paying the debt in full is not possible or appropriate then the directors should very carefully consider appointing a liquidator or administrator.

Again it is important to note that the company must be in liquidation within the 14 day period. To commence a voluntary winding up application, which is finalised outside the 14 day period, is not enough. Directors should be aware that it takes at least 7 days to initiate a voluntary liquidation. If the notice has been received late and you do not have a clear 7 days to initiate a voluntary liquidation, voluntary administration may be the only viable option.

There is no simple answer to the question of which direction directors should take in relation to personal liability notices however,

the point is clear that directors must act quickly after receiving such a notice.

Contact - Chris Smailes or Reagan Gruenthal.

Tax Sharing Agreement (“TSA”) – Protection against joint and several liability

The legislation governing consolidated groups is in Part 3-90 of Income Tax Assessment Act 1997. Division 721 provides that all members of a group can be jointly and severally liable to pay the tax liabilities of the head company if it fails to pay those liabilities when they are due and payable.

Clearly this could have unwanted consequences if it is wished, for example, to sell the shares in a group company to an unrelated buyer, which would not want there to be any chance that the former group company could remain liable for tax liabilities of the group.

Section 721-15, which provides for joint and several liability, also provides that joint and several liability will not exist if the group liability is covered by a TSA. For these purposes a TSA must comply with section 721-25; in essence it must provide for a particular amount to be determined as the member’s required contribution to the group liability and that the amount determined must represent a reasonable allocation. The TSA must be in force before the group liability becomes due and payable by the head entity.

The legislation provides a mechanism for a group member which is to leave the group to pay to the head company its allocated share of the group liability, and to be able to then leave the group clear of any liability to the ATO.

The ATO is empowered to call for a copy of a TSA, and if this is not provided within the time required then the protection from liability which would otherwise be available is taken never to have been available.

Tax Funding Agreement (“TFA”) – Providing an Accounting Framework

A purpose of a TFA is to provide for agreement between group members as to their liability to contribute to and fund payment of the tax liability of the group which is payable by the head entity. The group is not accountable to the ATO for the outcomes under a TFA, so in theory for example an agreement could be made for funding amounts which might not completely comply with the tax legislation or the ATO’s view of what is a reasonable allocation under Division 721.

A major purpose of the TFA is to provide for fair and reasonable allocations between members as regards deferred tax balances (a matter not usually covered in a TSA) and to ensure compliance with relevant accounting standards (AASB 112 and UIG 1052).

Unlike the TSA, a TFA will recognise that there may be situations when a head entity should give credit to or be liable to pay an amount to a group member, for example when the member’s activities give rise to losses which reduce the tax liability of the group.

Norton & Smailes can provide TSA’s and TFA’s which can be adapted to suit the circumstances of clients and the requirements of their auditors.

Contact: Richard Norton

Stamp Duty – Hidden dangers in cancelling transactions

The current uncertain economic circumstances may result in an increase in clients seeking to cancel agreements which have been signed, but are yet to settle. Naturally, there would be a number of legal and commercial issues to consider in relation to any attempt to cancel a prima facie binding contract.

A further aspect which should be considered at an early stage is the stamp duty implications of cancelling a dutiable transaction.

The good news is that the position in respect of cancelled transactions appears to be much clearer under the new *Duties Act, 2008 (WA)* (“the Act”), than under the former *Stamp Act, 1921 (WA)*. Generally, the Act applies from 1 July 2008.

In broad terms, section 107 of the Act provides that a “cancelled transaction” does not attract stamp duty, unless the transaction has been cancelled so that a “replacement transaction” or a “sub-sale transaction” can be entered into.

If the duty has already been paid, a refund may be sought from the Commissioner. Alternatively, if the duty has not yet been paid, the transaction will not be subject to duty, although in most circumstances it appears that the relevant instrument is arguably still required to be lodged at the OSR.

A cancelled transaction for the purposes of the Act is a dutiable transaction that has not, and will not, be carried into effect (subject to certain exceptions).

A sub-sale transaction means another dutiable transaction which results in a beneficial interest in the

dutiable property that was the subject of the cancelled transaction being held by:

- ◆ A person who is not a party to the cancelled transaction, a result which is contemplated or provided for under the cancelled transaction; or
- ◆ A person who is not a party to the cancelled transaction, a result which is substantially similar in effect to the cancelled transaction; or
- ◆ Another person, as a result of an agreement, arrangement or understanding between a person liable to pay duty on the cancelled transaction (normally the purchaser) and any other party to the transaction.

A replacement transaction is another dutiable transaction that is between all of the same parties as the cancelled transaction, is substantially similar in effect to the cancelled transaction and is considered by the Commissioner to be a scheme or arrangement, or part of a scheme or arrangement, for which the sole or dominant purpose is to avoid, reduce or defer the payment of duty.

For example, A and B enter into an agreement to transfer dutiable property and then cancel the agreement so that another agreement for the transfer of the same property between A and B can be entered into when lower rates of transfer duty come into effect. The Commissioner is likely to consider that the second transaction is a replacement transaction. The Commissioner would be likely to charge duty on the first transaction and it would not be able to be cancelled for stamp duty purposes.

There are a number of technical and practical issues which need to be considered in relation to seeking to ensure no stamp duty is required to be

paid on cancelled transactions including:

- ◆ Ensuring that a purchaser who wishes to cancel a transaction, and who may be seeking to assist the vendor to find another purchaser, does not jeopardise their ability to seek a refund of stamp duty, by causing a sub-sale transaction to occur;
- ◆ Ensuring that the exceptions to the concession for cancelled transactions do not apply; and
- ◆ Timing issues to ensure that, where possible, clients are not required to pay the duty and then apply for a refund, but rather are not required to pay duty on a cancelled transaction at all.

Contact: Johanne Thomas or Chris Smailes.

Norton & Smailes

We advise on:

- income tax, GST, capital gains tax, FBT
- superannuation and superannuation deeds
- stamp duties, payroll tax and other State taxes
- wills, estate planning and business succession planning
- trusts and trust deeds
- objections and appeals
- tax and commercial litigation
- commercial law

Standard Documents (24 hour turnaround)

The following is a summary of our charges (excluding GST and

disbursements) for the provision of final documents in duplicate and attending to stamping:

Deeds

- **Trust Deeds**

Discretionary Trust Deeds are \$240, and Unit Trust Deeds are \$295.

- **Superannuation Fund Deeds**

We provide Superannuation Fund Deeds for \$395. This includes supporting minutes, member information statements and all relevant documentation.

Other Documents

- **Enduring Power of Attorney**

An Enduring Power of Attorney is \$150, and a General Power of Attorney is \$220.

- **Wills**

We also provide Wills, including Testamentary Trusts where required. Estimates of fees can be provided.

- **Buy/Sell or Business Succession Agreements**

Estimates of fees can be provided.