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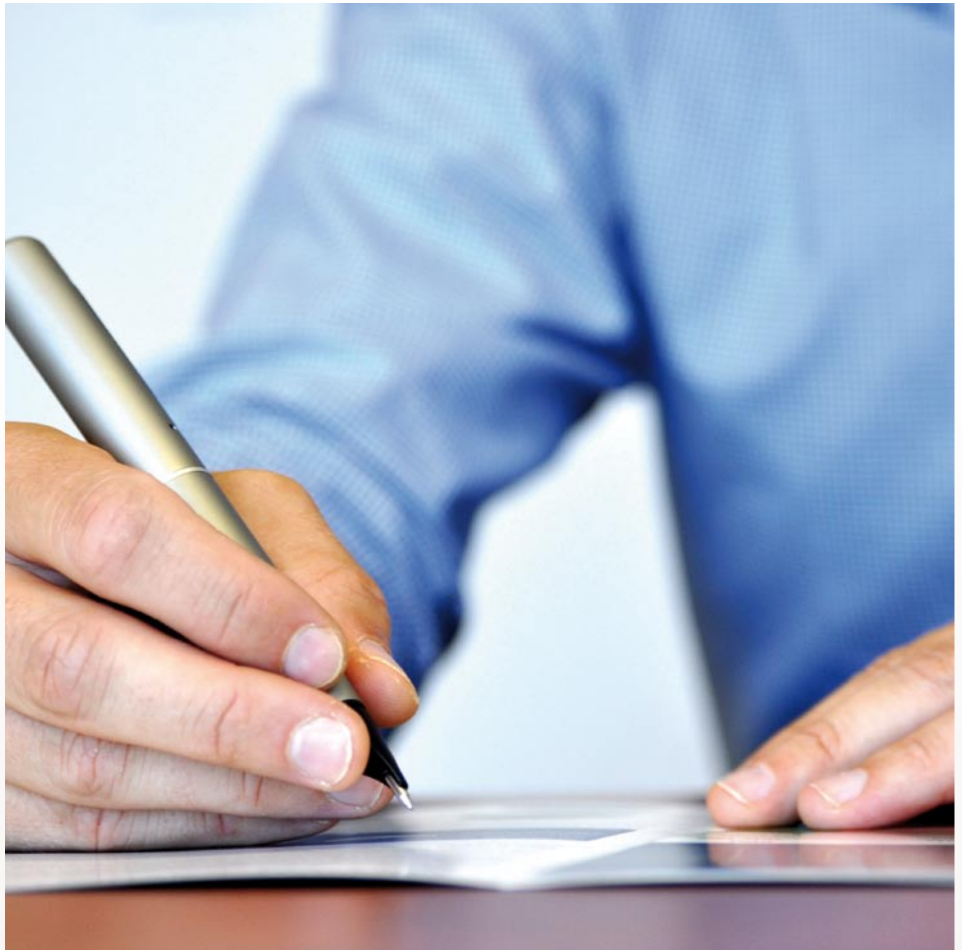
Esplins Law Report

AUGUST 2011

Impending Changes to Taxation of Trusts

Trustees must make important decisions.



As a consequence of the decision of the High Court in *Commissioner of Taxation v Bamford* [2010] HCA 10 a number of changes have or will be made to the taxation laws in relation to trusts. These changes will principally:

- address the alignment of the concept 'income of the trust estate' for trust law purposes and 'net income of the trust estate' for tax law purposes;
- enable the streaming of capital gains and franked dividends by the trust to the trust's beneficiaries.

The Government introduced new tax laws on 29 June 2011 to address the second matter referred to above but decided to wait for further input and discussions to address the first matter.

With effect from, and including the 2010/11 tax year, capital gains and franked dividends can be streamed direct to beneficiaries in certain circumstances for tax purposes so that the beneficiary rather than the trust pays capital gains tax or pays tax on the franked dividend after allowing for the franking credit. For this purpose it is important that the beneficiary becomes "specifically entitled" to the capital gain or dividend.

The changes only affect trusts that made a capital gain or received franked dividends in the 2010/11 or later tax years and beneficiaries are made "specifically entitled" to such capital gain or franked dividends. However it is important to ensure that the trust deed contains powers which allow the trustees to stream the trust's income. If you are unsure you should consult with your lawyer or accountant.

The changes to the tax laws specifically allow trustees of "managed investment trusts" to choose whether to apply the streaming changes in the 2010/11 or 2011/12 tax years. Trustees of "managed investment trusts" must make the decision within two months.

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Insolvency & Directors' Obligations

Whether the company was solvent or insolvent at the time of liquidation becomes a live issue.

If companies continue trading whilst they are insolvent directors can be exposed to personal liability for debts incurred and for unpaid tax. The question of when a company is or is not insolvent is particularly relevant and on many occasions it is difficult or impossible to accurately pinpoint the time insolvency commenced.

The Corporations Act provides that a company is solvent only if it is able to pay its debts as and when they become due

and payable. Before recent changes to the Corporation Act there was an additional requirement that had to be satisfied – namely, the company had to be able to pay its debts from **its own money.** This additional requirement made it very difficult to satisfy the solvency requirement.

Determinations of solvency are made by reference to commercial realities. If a company has a resource available to it to enable it to pay all its debts as they become payable the company will be solvent. The resource available to the company could be an unsecured borrowing which is not immediately repayable or a voluntary extension of credit by another party such as a related company or a director or shareholder.

Accordingly, companies can avoid insolvency if they have a related party, director or shareholder who is prepared to make available monies to the company to pay its debts as they fall due for payment. Directors, however, need to be vigilant. If a company goes into liquidation, the liquidators will look to recover from creditors any payments made by the company in a 6 month period prior to the liquidation so as to fund the cost of the liquidation. In these circumstances, whether the company was solvent or insolvent at the time of liquidation becomes a live issue to be determined by the Courts at considerable cost.

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Timing is important for developers wishing to use GST margin scheme provisions

Administrative Appeals Tribunal decision provides an important insight.

The recent Administrative Appeals Tribunal decision in ***Cyonara Snowfox Pty Ltd v Commissioner of Taxation [2011]*** AATA 124 provided insight into the way that the Courts/Tribunals will treat developers wishing to elect to use the Margin Scheme Provisions of the GST Act, and the timing of that election. In this case the taxpayer, being involved in the business of land development and sales, undertook the following in sequence: purchased land; subdivided that land; sold two lots (lots 1 and 9) to separate purchasers with the purchase price including GST; elected to apply the margin scheme to the sales; sold a further lot as a sale of a "going concern".

In its decision the tribunal found that the taxpayer is required to makes its election to apply the margin scheme no later than the time of supply, that is "at or prior to settlement" of the sale of the properties. Cyonara argued that by not electing to apply the margin scheme at settlement it had in effect not made any decision and therefore it was open for it to make the election at a later date. As stated in his reasons, Deputy President Hack SC replied that following settlement, ***"it is enough to decide that it is no longer open to Cyonara to choose to apply the margin scheme to the sales of lot 1 and lot 9".***

While this case also clarified a number of other issues in relation to the supply of a going concern and whether the commissioner was statute barred from claiming GST, the effect of the above decision in regards to the margin scheme highlights the importance of the timing when making an election to apply a margin scheme.

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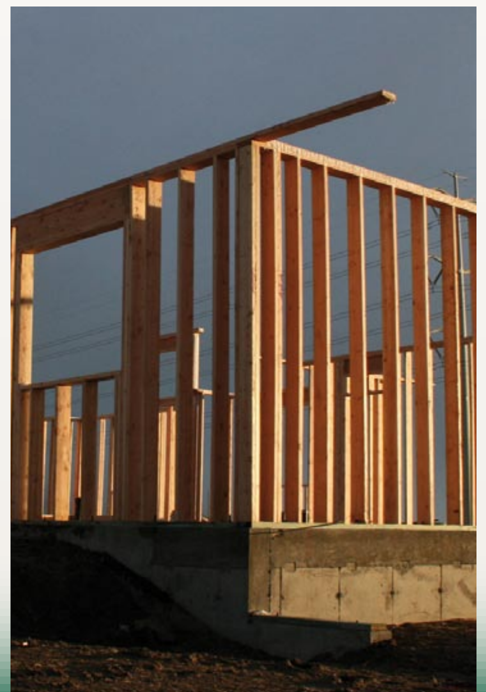

Welcome to Section 34AA - A common sense and practical response to residential DA disputes

New development in the dispute resolution procedure.

On 7 February 2011, Section 34AA was introduced into the ***Land and Environment Court Act 1979*** requiring the Land and Environment Court to arrange a ***mandatory*** conciliation conference for any appeal regarding a development application or modification to a development consent relating to a detached single dwelling or dual occupancy (including subdivision) or to alterations or additions to such dwelling or dual occupancy.

The new mandatory conciliation regime applies to all relevant appeals lodged in the NSW Land and Environment Court after 7 February 2011.

This new development in the dispute resolution procedure of the Court is an attempt to save the costs, time and resources of all parties in the resolution of relatively simple residential development appeals such as proposed roof renovations, garage extensions, room additions etc. The then NSW Attorney General, Mr Hatzistergos, in his Media Release on 6 February 2011, announced that the Court expects to finalise 95% of these types of disputes within 3 months of their commencement in the Court.

Once a relevant appeal application is filed in the Court, the Court will arrange a conciliation conference. The parties must participate in the conference in good faith notwithstanding whether or not they consented to the conference. The conference can be conducted on site of the development and will be presided by the Commissioner of the Court who will try to assist the parties to reach a mutually acceptable binding agreement. If the parties have difficulty in reaching the agreement, the Commissioner will be obliged to terminate the conciliation conference, conduct the hearing immediately and make a final binding decision. Accordingly, the parties will need to be ready for their appeal to be heard on the date set down for the conciliation conference. Alternatively, if the parties consent, the Commissioner must determine the appeal on the basis of what has occurred at the conciliation conference.

The parties may opt out of the mandatory conciliation process by lodging an application with the Commissioner of the Court setting out the reasons why the appeal is not suitable for the conciliation. If the Court determines that the appeal is not to be dealt by way of the conciliation procedure, the proceedings will be determined in a court hearing.

Section 34AA is a welcomed addition to the legislation and will greatly assist to expedite approval of residential DA applications.

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Amendments to Retail Leases Act

Retail Leases Amendment Regulation 2010 and Retail Leases Amendment Bill 2011.

On 10 December 2010, the New South Wales Government published the ***Retail Leases Amendment Regulation 2010***, which commenced on 1 January 2011. The object of the Regulation was to amend the ***Retail Leases Act 1994*** by replacing the current form of the Lessor's and Lessee's Disclosure Statements in line with the national uniform disclosure statement which is endorsed by the Small Business Ministerial Council. At least seven (7) days before a Lessee enters into a retail shop lease, the Lessor must provide the Lessee with the Lessor's

Disclosure Statement. The new Regulation requires for a much more detailed Lessor's Disclosure Statement to be provided to the Lessee. The Lessee must, no later than seven (7) days after receiving the Lessor's Disclosure Statement, sign and provide to the Lessor the Lessee's Disclosure Statement acknowledging receipt of the Lessor's Disclosure Statement.

On 10 January 2011, the New South Wales Government published the Retail Leases Amendment Bill 2011, which is yet to be assented to by the Government. The object of the Bill is to amend the ***Retail Leases Act 1994.*** There are numerous amendments including, inter alia: simplification of the procedure for the various Disclosure Statements that a Lessor and Lessee are required to provide; variation of the Lessor's Disclosure Statement to make it clear that the Lessor must provide a Disclosure Statement when a retail shop lease is to be renewed; and provision to enable a Lessee to require a Lessor's Disclosure Statement prior to exercising an option to renew a lease.

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Is the sale of land to the State a taxable supply?

Taxpayer ordered to pay $252,000 GST.

In ***SXGX and Commissioner of Taxation [2011] AATA 110***, the Tribunal found that the sale of land by the taxpayer to the State was a taxable supply and subject to GST.

In 2002 the taxpayer became registered for GST and acquired land to establish a car dealership.

In late 2005, the QLD Government announced plans to construct the Eastern Busway and contacted the taxpayer as a property owner likely to be affected.

In 2007, the taxpayer attempted to sell the land, but the sale fell through when the purchaser learned of the State's proposal.

The taxpayer received a letter from the State in 2008 stating that formal resumptions had not commenced as certain parcels of land, including the taxpayer's, were still in consideration. The taxpayer sent a letter to the QLD Government requesting that its land be acquired "sooner than it would otherwise" as it would suffer a hardship if the land was not purchased.

The parties negotiated a purchase price of $2.77 million including GST. The taxpayer lodged a BAS for the tax period and did not account for the sale of land.

The Tribunal took into consideration the following:

1. The land had been considered for resumption but not confirmed;
2. The taxpayer negotiated the price with the State;
3. The taxpayer executed an agreement to sell, and executed and delivered a transfer of land; and
4. The State did not use the powers under the Acquisition of Land Act.

The Tribunal found that the steps taken by the taxpayer to sell the land differed from the steps taken by a taxpayer whose land is resumed by the State.

The Tribunal noted that the definition of "supply" is very wide and included a conveyance. Furthermore, the Tribunal determined that the sale was in the course of the taxpayer conducting its enterprise.

The Tribunal found that the requirements of section 9-5 of the GST Act were satisfied and ordered the taxpayer to pay GST in the amount of $252k.

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LEGAL UPDATE

Torrens Assurance Levy

In our Spring 2010 Law Report, we featured the introduction of the Torrens Assurance Levy which commenced on 1 July 2010, whereby a sliding scale levy was payable to the Land & Property Management Authority upon lodgement of transfers for registration.

On 24 May 2011 the NSW Government passed legislation to abolish the Torrens Assurance Levy. From 1 July 2011 the Torrens Assurance Levy is not payable upon lodgement of transfers for registration unless the transfer relates to a contract for sale of land which was entered into between 1 July 2010 and 30 June 2011 and the consideration for such sale is more than $500,000.00.

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New requirements for pre-litigation and dispute resolution

April 2011 has seen vast changes to civil procedure in New South Wales.

The recent Amendments to the NSW Civil Procedure Act 2005 commenced on the 1 April 2011 and include new provisions, which place new requirements on both lawyers and their clients to ensure that litigation is viewed as a last resort and not the first step in respect of civil disputes.

According to the NSW Hansard these changes will encourage the "just, quick and cheap resolution of the real issues of civil disputes before they commence in Court" and will likely lead to vast improvements in the efficiency and the operation of the New South Wales Justice system.

These amendments should encourage people to resolve their disputes outside the legal system, and will likely increase the role of alternative dispute resolution over the more costly adversarial approach.

The new provisions require each party to a dispute to demonstrate prior to their commencement of formal litigation that they have taken reasonable steps to:
(a) resolve the dispute by agreement; or
(b) clarify and narrow the issues in dispute.

In most cases "reasonable steps" will include an exchange of information about the subject matter of the dispute and any relevant documents and engaging in negotiation to attempt to resolve the dispute.

Failure to comply with the pre-litigation requirements does not prevent a person from commencing, responding to or continuing with litigation, but it does risk a number of potential consequences including costs orders against the parties and their lawyers.

In a practical sense, the parties must now file a dispute resolution statement detailing their compliance with these pre-litigation requirements at the time of filing their first substantive pleadings. The "reasonable steps" requirement does not require the parties to do anything more specific than what is reasonable in terms of time and legal costs by reference to a party's circumstances, including the nature of the dispute and the value and complexity of the claim.

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