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## February Newsletter

*This newsletter deals with securing payment of shareholders' loans, onerous superannuation calculation changes, and changes to Foreign Investment Review Board requirements for property investments.*

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### **CORPORATE COMMERCIAL**

#### **SECURING PAYMENT OF SHAREHOLDERS' LOANS**

In times of financial distress, the owner of shares in a company which conducts a business is vulnerable to the loss of moneys advanced to or retained by the company. Many owners are owed substantial sums of money by the companies through which they operate their businesses. Clearly documenting and where possible, taking security for repayment of those moneys, can improve the likelihood of some or all of the money being repaid, in the event of the company going into administration, receivership or liquidation. The need for shareholders to secure their debts is at an 80 year high.

In a liquidation, the assets of the company in liquidation are realised, normally by sale, and are applied to the payment of debts and the satisfaction of liabilities. Not every debt is given the same priority as every other debt. Some debts are given a greater priority for payment than others. If, for example, there is \$1 million available to satisfy debts of \$2 million, a normal and equal division would see every creditor receiving \$0.50 for every \$1.00 of debt. If, however, creditors who are owed \$1 million have a first ranking priority as to the net proceeds of sale, then they will receive payment of all of the available \$1 million. Creditors who have a lesser ranking priority will receive nothing.

The law carefully defines priority rules which apply to various classes of debt. The holder of a security for payment of debts has a higher ranking priority for payment as to the net proceeds of sale of the secured asset than a creditor who has no security for payment. Typically, a trading company will grant a first ranking fixed and floating charge to its bank, which will secure to the bank a very good chance of being paid most or all of what is owed if the company fails. Unsecured creditors and shareholders typically receive little or nothing. Shareholders, with the consent and agreement of the company's bank, can often achieve a second ranking priority security which gives some prospect of recovery of all or part

of the debt owed to the shareholder. Again, to illustrate the point by example, where there is \$1 million available from the sale of the secured assets to satisfy debts of \$2 million, \$500,000 is owed to the bank which has a first ranking priority and \$500,000 is owed to the shareholder who has a second ranking priority. The bank is paid its \$500,000 first, and then the shareholder is paid his or her \$500,000. Unsecured creditors and those with a lower ranking priority than the shareholder who has a second ranking security will receive nothing. Without a security, the shareholder would not receive anything unless all creditors, including unsecured creditors, had first been paid their debts in full.

It is usually too late for security to be given if the company is already suffering financial distress. A security given when the company is unable to pay all its debts as and when they fall due and payable, is almost certainly going to be found to be invalid, if challenged by a liquidator. If the liquidator's challenge is successful, then the shareholder will rank for payment of his or her debts as an unsecured creditor. Also, a security given by a company within 6 months of the commencement of its winding up will, except in special circumstance, be void and unenforceable.

A further benefit of documenting the amount of your company's indebtedness to you is that you are likely to be able to prove the existence and details of the debt. Many shareholders have failed to convince a liquidator and the court that they are owed anything by a company in liquidation, because they are not able to produce acceptable proof of the debt. A properly prepared and signed loan agreement will normally be sufficient proof. If the loan agreement is also coupled by a valid charge, then the shareholder has a much better chance of recovering payment of his or her debt than a shareholder whose records have not been formalised does.

There are some expenses involved in a shareholder properly documenting and taking security for payment of advances and other indebtedness. These include the legal fees involved and, in New South Wales and

South Australia can also include mortgage duty. However, in many cases, the need to pay mortgage duty can be reduced or avoided.

If you are in a situation of being owed money by your company and do not have any security for its repayment, then you should take advice promptly to see whether it is possible to improve your position. Do not wait until difficult times arrive. This is something that you need to attend to without delay.

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## INDUSTRIAL RELATIONS AND SUPERANNUATION

### CALCULATIONS OF AMOUNTS NEEDED TO BE

#### CONTRIBUTED FOR SUPERANNUATION PURPOSES

The Commissioner for Taxation is about to introduce sweeping changes to the calculation of the minimum prescribed superannuation contributions.

On 5 November 2008, the Commissioner for Taxation issued Draft Ruling SGR 2008/D2 *Superannuation Guarantee: Meaning of 'ordinary time earnings' and 'salary or wages'* ("Draft Ruling"). The final ruling is expected to be formalised on 6 May 2009 and may be applied retrospectively.

Under the previous 1994 ruling, employers were entitled to calculate superannuation contributions on behalf of an employee using an award stated earnings base. Legislation which came into effect in July 2008 mandates that all superannuation contributions be calculated on 'ordinary time earnings' (OTE). Pursuant to the Draft Ruling, the OTE includes items over and above salary and wages and includes **commissions, parental leave, holiday and long service leave, overtime** (where it is regularly worked), **performance based bonuses, shift and casual loading, allowances, the labour component of payments to contractors and over award payments.** It expressly excludes payments such as travel and car allowances or reimbursement and benefits for which FBT is attracted and payments in lieu of notice or on redundancy and workers compensation payments.

As such superannuation contributions should be revisited at each payment time and adjusted to incorporate the correct OTE which will be an added administrative burden for employers and increase most employers' liability for employee superannuation. Failure to correctly calculate the 9% superannuation guarantee contributions for employees may result in the employer incurring the superannuation charge.

Whilst **all** employers will be impacted by the ruling, the manufacturing, transport, large construction projects, healthcare and mining sectors are likely to be heavily impacted by these changes.

As such, employers need to revisit their calculations of employee superannuation contributions on an individual basis and update any relevant software or payroll systems as well as inform employees of any changes to their superannuation contributions.

Commentators and business groups are calling for the Government to overturn the Draft Ruling and are threatening legal challenges. However, unions have vowed to fight any push to overturn the Draft Ruling.

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## PROPERTY

### Changes to Foreign Investment Review Board Requirements for Property Investment

The Australian Government has announced proposed changes to streamline investment by foreign interests in Australian real estate. These include:

- removal of the generally administered 50% cap on the percentage of new dwellings in a development that can, with permission, be sold to foreign investors. Whilst there will no longer be a general cap under the proposal, applications will still be decided on a case by case basis, and there is an obligation to market locally;
- new dwellings that can be sold to foreign investors on the basis of specific or blanket approvals, will now include dwellings that have been rented, provided they have not been rented for more than 12 months;
- the cap of \$300,000 on the purchase price paid by a foreign student who is resident in Australia for their principal place of residence has been removed;
- it is easier for foreign companies to acquire residences for occupation by staff in Australia, provided that they must sell them or rent them if not used by staff for more than 6 months;
- where vacant land is acquired by a foreign interest, the general requirement for construction to commence within 12 months has been extended to 24 months;
- approval is not required for acquisition of resorts or hotels for a price of less than \$50m, provided they are not heritage listed.

Whilst some of the amendments require legislative change that is yet to come into force, it may be that the Government will, as an administrative matter, apply some of the changes immediately. Specific review of the final legislation for particular circumstances is still required.

In the meantime, the position for long stay business visa holders remains that they can acquire a residence for the duration of their work in Australia, but must dispose of the property upon cessation of their visa.

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