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July 2006 Newsletter

This newsletter deals with recent developments as to the operation of the "small business CGT concessions", director's penalty notices for unpaid PAYG tax and the operation of the Work Choices Legislation in relation to executive and other employment contracts and business sales.

TAXATION

OPERATION OF SMALL BUSINESS CGT CONCESSIONS: RECENT DEVELOPMENTS

(a) Introduction

The small business CGT concessions ("concessions") are outlined in Division 152 of the *Income Tax Assessment Act 1997* and have been in operation for some time. The effect of the concessions is usually to reduce the otherwise assessable capital gain to nil or 25% of the gain. Thus, the operation of the concessions is important as to:

- choice of entity to carry on a business and the holding of equity in such entity;
- choosing whether the assets of a business or the equity in the business should be sold; and
- calculating the tax liability on the sale of the asset.

In the last two months:

- the Treasurer announced certain proposed changes to the operation of the concessions which, undoubtedly, widen the ambit of the concessions; and
- the Australian Taxation Office ("ATO") has issued Draft Taxation Determinations ("TDs") that outlines the ATO's views on certain aspects of the concessions.

(b) Proposed amendments to the concessions

In the Treasurer's Press Release Number 038 dated 9 May 2006, the Treasurer announced:

- that the current "controlling individual test" (which requires an individual to hold 50% of the equity in order to access, for example, the "retirement exemption") will be replaced by a "significant individual test" (which requires the individual to only hold 20% of the equity); and
- in relation to the "significant individual test", the test can be satisfied either directly or indirectly through one or more interposed entities.

The proposed changes apply from 1 July 2006.

The significance of these proposed changes are:

- unit trusts with individuals directly or indirectly holding a 20% interest will become more popular as entities to carry on business;
- a person who holds 20% or more of the equity in the business may now be able to access the concessions; and
- the "retirement exemption" should be more accessible.

(c) Draft TDs

On 14 June 2006, the ATO released 13 draft TDs dealing with aspects of the concessions. The following is of particular interest:

- in TD2006/D23, the ATO confirms that a CGT asset leased by a taxpayer to a "connected entity" for use in the connected entity's business is an "active asset";
- in TD2006/D25, the ATO confirms a share in a company or units in a unit trust can qualify as an "active asset" if the company or trust owns interests in another entity that satisfies the "80% test". In essence, a share in a company or units in a unit trust can be an "active asset" if the "80% test" is satisfied on a tracing basis;
- in TD2006/D30, the ATO states that a taxpayer must receive an amount from a CGT event to qualify for the "retirement exemption". In non-arm's length transactions, where an amount would not otherwise be paid, this means an amount representing the "retirement exemption" must be paid.

(d) Tax planning

The Treasurer's Press Release, together with the ATO's TDs, are good news and have the effect of continuing the emphasis of utilising, wherever possible, the concessions to reduce the tax liability on the sale of an asset.

Further, if the net assets of the taxpayer and associated entities are getting close to the \$6m concession threshold, consideration should be given to utilising the concessions so that:

- a tax-free or substantially tax-free capital gain can be realised by the taxpayer (which is not available once the \$6m net value threshold is exceeded);
- the new entity that purchases the asset has a cost base, for CGT purposes, of

\$6m in relation to the business that was previously carried on by the taxpayer.

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INSOLVENCY

UNPAID PAYG TAX – DIRECTOR'S PENALTY NOTICES – PERSONAL LIABILITY

IGNORE THEM AT YOUR PERIL

A Director's Penalty Notice ("DPN"), also known as a Section 222AOE Notice, is served by the ATO on a company director specifying the outstanding relevant corporate PAYG tax liability and requiring 1 of 4 alternatives to be adopted within **14 days**.

These options are:

- (a) cause a **voluntary administrator** to be appointed to the company;
- (b) cause the company to be **wound up**;
- (c) enter into a **formal repayment agreement** with the ATO for full repayment of the outstanding taxation debt; or
- (d) **pay** the outstanding taxation.

If you do not comply with the DPN, a penalty will be imposed upon you equivalent to the total outstanding PAYG tax liability. Thereafter, you are **personally liable** for this sum as a debt owed by you to the ATO. The ATO will then commence Court proceedings to recover the sum from you as a debt.

You need merely to have been a director of the company at the time the tax became payable, although a DPN can also be served on a person appointed as a director after the tax becomes payable. As such, your subsequent resignation as a director will provide no defence.

In the decision of *Re Application of Rade Stojic* on 24 May 2006, the NSW Supreme Court permitted a company that was deregistered for failure to lodge its annual return with ASIC, to be reinstated to enable

the sole director to wind up the company within 14 days of receiving the notice so that he could avoid liability for any unpaid tax.

Shadow directors and de facto directors have also been pursued by the ATO following service of a DPN.

The Full Federal Court held on 8 June 2006 in the case of *Guss v DCT* [2006] FCAFC 88, that the issue of a DPN on a director of a company was not a reviewable decision under the *Administrative Decisions Judicial Review Act 1977*. The Court held that the issue of the DPN did not confer, alter or affect the legal rights or obligations of the director. Therefore, the decision to issue the DPN was not a decision that could be the subject of review.

In the decision of 19 June 2006 in *DCT v Keck*, the NSW Supreme Court deemed effective service of a DPN when the notice was posted even though there was no evidence of it ever having been received. The Court said the mere fact of non-receipt did not provide the directors with any defence and the ATO was entitled to judgment against each director for unpaid tax plus interest.

There can be no doubt (as evidenced by the above cases) that the ATO has become more vigilant in recent times in pursuing directors for unpaid PAYG tax. If you ignore a DPN served upon you, irrespective of the fact you may have been out of Australia, sick or claim to never have received the DPN, you will become personally liable for the unpaid debt.

As such, you must ensure you act within the 14-day time period. With the appropriate action, you will totally avoid any personal liability. The ATO is not interested in reaching a compromise to accept a part payment.

If the company pays PAYG tax to the ATO and that sum is clawed back as a preference payment by the company's liquidator from the ATO, the ATO can seek indemnity from the director personally for the tax amount clawed

back. As such, early professional advice is recommended.

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WORK CHOICES LEGISLATION EXECUTIVE AND OTHER EMPLOYMENT CONTRACTS AND BUSINESS SALES

The introduction of the Work Choices Legislation is progressively changing the rules for employment relationships. In many cases, there is no immediate effect. This is because existing awards are, in substance, preserved until the earlier of their expiry or three years after the legislation came into force. There are rules to be followed in seeking to change existing awards in the interim period.

There are, however, some immediate issues for employees and employers negotiating new executive service and other employment contracts and in transfer of business situations.

For example, for award employees once existing preserved awards expire, and for non-award employees in any event, there may be no right to receive a redundancy payment on a genuine redundancy.

This is regardless of the number of employees in the business, unless such a right is expressly set out in a replacement award, agreement or in an individual employment contract.

There is no statutory requirement to provide redundancy pay as a minimum entitlement for new agreements with employees.

In addition, claims for unfair dismissal (but not for unlawful dismissal) have been curtailed for companies with up to 100 employees, and may be more difficult in companies above that threshold.

Whilst this will create additional flexibility for employers, well-informed employees are likely to seek redundancy provisions and protections against unfair dismissal in their

individual employment contracts. This would, for example, be likely to be raised by an employee who is moving to a new position.

On a sale of business, employees may be less than enthusiastic about taking employment with the purchaser (rather than seeking access to an existing redundancy entitlement with the vendor) where the purchaser is offering employment which (at least after the 12 month period under which the purchaser may be bound by the vendor's award conditions) may not offer employees the same terms, including access to redundancy entitlements.

The attractiveness of moving will also be reduced where the vendor has over 100 employees whilst the purchaser has employees under that amount.

There are, accordingly, new issues and dynamics in employment agreements and sales of business, which will require more focus on the employment aspects.

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