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June 2004 Newsletter

This newsletter deals with proposed changes to bankruptcy laws, the Budget changes to pensions paid by trustees of self-managed superannuation funds and the limitation of the ability of the Industrial Commission to rewrite commercial contracts.

ASSET PROTECTION

PROPOSED CHANGES TO BANKRUPTCY LAWS

Last month, the Federal Government released an exposure draft of proposed changes to the bankruptcy laws. One object of these changes is to allow the bankruptcy trustee to recover assets that a bankrupt has transferred to third parties (such as family members, trustees of family trusts and companies) to avoid creditors getting hold of the assets.

The proposed changes are far-reaching and significant. For example, if a bankrupt lends a third party (not necessarily a family member) money to assist that party to buy property and then retains a direct or indirect benefit from that property, the bankruptcy trustee may be able to seize the property from the third party and sell it for the benefit of the bankrupt's creditors. The trustee will be able to do this if:

- the loan was made within ten years of the date of the bankruptcy; and
- the loan was not at arm's length or was not for full market value or consideration; and
- the loan was made for a "tainted" purpose, i.e. to prevent the property

or money from becoming available to creditors or to hinder or delay the

division among creditors or it can be inferred from the circumstances that this was the bankrupt's intention; or

- the borrower knew of the "tainted" purpose.

In seeking to recover the property or any retained loan money, all the trustee needs to do is to allege that the transaction was entered into for a "tainted" purpose. To prevent the trustee seizing the property or money, the burden is on the bankrupt or the third person to show that the transaction is not "tainted". This is the opposite of the current legal position where the onus is on the trustee to show improper purpose.

The most common transaction that may be caught is where a person buys a home in the name of their spouse or partner, pays the mortgage through a joint bank account and continues to live in the home (so the person derives an indirect benefit). The proposed changes may also catch a purchase by a parent of an expensive car for a child (where the parent drives the car occasionally) or property acquired by a company for the use of the bankrupt (where the bankrupt derived less than market value remuneration).

These proposed changes will commence on Royal Assent. They will apply to all non-market value transactions and to full market value transactions less than ten years old.

The Exposure Draft has been referred to the House of Representatives for inquiry and report by 16 July 2004.

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SUPERANNUATION

ABILITY OF TRUSTEE OF SELF-MANAGED SUPERANNUATION FUND TO PAY A COMPLYING PENSION

Where members have funded accumulated benefits in their own self-managed superannuation fund ("SMSF") in excess of the lump sum reasonable benefit limit ("RBL") (currently, \$588,056), a common strategy has been, when a "condition of release" occurs (e.g. retirement from the workforce at the age of 55), for the trustee of the SMSF to pay to the member a "complying pension".

The advantages of paying a "complying pension" are:

- the pension RBL applies rather than the lump sum RBL so that the amount funding the pension may not be "excessive";
- the amounts taken into account for pension RBL purposes are not, in fact, the members' accumulated benefits and may be an amount substantially less than that amount (so that even accumulated benefits in excess of the pension RBL may not be "excessive"); and
- the ability for the member to claim a 15% rebate on tax on the pension received.

Announced in the Budget (and subsequently made law by way of gazetted

Superannuation Industry (Supervision) Regulations) ("Regulations") were changes in relation to the ability of the trustee of a SMSF to pay a "complying pension". Where an SMSF is established after 12 May 2004, the trustee of the SMSF will be unable to internally fund a "complying pension". The trustee of such a fund has a choice to pay the following pensions:

- an "allocated pension" (which is subject to lump sum RBL);
- the proposed "market linked" pension which are expected to be available from 30 September 2004; and
- pensions purchased from life insurance companies.

The Regulations also state where a superannuation fund was established before 12 May 2004 and the governing rules of the fund are amended after that date "to provide for the payment of a defined benefit pension" (being a "complying pension"), the fund is unable to fund a "complying pension". By inference, if a SMSF deed established prior to 12 May 2004 "provides for the payment of a defined benefit pension", then the trustee of the SMSF is able to fund a "complying pension" in the future notwithstanding that the fund is, at present, in accumulation stage.

The question arises as to when do the governing rules of an SMSF "provide for the payment of a defined benefit pension". The Australian Taxation Office ("ATO") takes the view that the explicit terms and conditions of the pension must be found in the SMSF's governing rules and that those terms and conditions may include:

- the person to whom the pension is to be paid;
- the reversionary beneficiary(s), if any;
- the amount of the pension and any indexation provision; and

- other specific terms and conditions governing the operation of that pension.

If the ATO's view is correct as to what is meant by the governing rules "providing for the payment of a defined benefit pension", then it is likely that **no** SMSF deed will enable the trustee of such a fund to pay a "complying pension". This is because most deeds are drafted simply in terms of giving the trustee power to fund a pension in terms of the Regulations.

As a matter of interpretation, there is considerable doubt whether the ATO's view is correct. Senator Coonan has indicated that some changes may be made.

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COMMERCIAL LAW

LIMIT ON INDUSTRIAL RELATIONS

COMMISSION JURISDICTION TO RE-WRITE COMMERCIAL CONTRACTS

One of the more troubling developments in recent years has been the trend of the NSW Industrial Relations Commission ("IRC") to re-write commercial contracts using the power in Section 106 of the *Industrial Relations Act* to deal with an "unfair contract whereby a person performs work in an industry".

Various IRC Judges have extended these quoted words to include many types of commercial arrangements – for example, a commercial lease to a company that required the tenant to trade.

A demonstration of this principle is found in the judgment of Hungerford J in the case of *Mitchforce Pty Limited v Starkey*, where a corporate lessee obtained orders for the granting of an option lease even though the lessee had not met its rental for the initial term, because the lessee's expectation of development in the local area had not come

to pass. The judge found the IRC had jurisdiction because the lessees were working proprietors of a business, the lease required the lessee to carry on a business and by necessity the lease contemplated the performance of work. The Full Bench of the IRC accepted this view on appeal.

In June last year, the NSW Court of Appeal (by a majority) took the view that if the IRC decision stood, then just about every commercial contract would be subject to the jurisdiction of the IRC. As one of the appeal Judges noted, even an insurance contract involved the work of an insurance clerk so that if the IRC's approach was correct, there may be no practical limit to the grounds on which commercial contracts can be re-written.

The problem for the Court of Appeal was the restrictions on appeals from the IRC. Accordingly the Court of Appeal decided to adjourn whilst the IRC reconsidered the issue.

In late December 2003, the Full Bench of the IRC decided to reverse its earlier decision and accept the views of the Court of Appeal that the IRC had no jurisdiction in this case. This meant that the lessee finally lost.

Whether the IRC will follow the Court of Appeal in less extreme cases is uncertain. However, it is pleasing that the Court of Appeal has expressed clear concern about the determination of commercial cases by judges who are not familiar with such cases.

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