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June Newsletter

This newsletter deals with a new national system for registration of securities and the Budget announcement as to proposed taxation of shareholders or their associates of the use of property or chattels held by private companies.

COMMERCIAL LAW

FINALLY – A NEW NATIONAL SYSTEM FOR REGISTRATION OF SECURITIES

(a) Background

Nearly 60 years after the law in the United States of America was reformed, and nearly a decade after similar change took place in Canada and New Zealand, Australia is finally getting around to reforming the law on personal property securities. The present law in Australia is best described as a confusing mess. There are 77 different pieces of legislation, and many principles of common law which govern the granting, registration and enforcement of security interests in personal property. If and when it is enacted, the *Personal Property Security Bill* will bring all of the legislation into one place, greatly reducing complexity and costs and increasing the availability of finance.

Essentially, the *Bill* deals with personal property which means all property other than interests in land. Securities charging interests in land will remain the subject of separate State law.

The present timetable for completion of the reform and commencement of the new *Personal Property Security Act* (as it will be known after the *Bill* is enacted), is that it will commence operation in May 2010. The Federal Government has a very large task to complete the legislation and to create the necessary new infrastructure in time to meet that deadline.

(b) Essential features

The essential features of the proposed new law are:

- of the existing registers, including the ASIC charges register and the motor vehicle security registers in each State. There will be a system of migration for existing charges to the new system;
- the many and various descriptions of different forms of security e.g., debenture, mortgage debenture, mortgage of share, retention of title, factoring agreement, assignment of book debts, conditional sale agreement, bill of sale, hire purchase, chattel lease, crop mortgage, crop lien, stock mortgage, pledge etc, should all be replaced by the expression “security interest”;
- the present distinction between fixed and floating charges will become largely meaningless;
- there will be a system of sending out verification statements to enable errors to be identified and corrected, and to let both the grantor of a security interest and the secured party both know that the security interest has been registered;
- much clearer rules will apply to determine priority of competing security interests when they are being enforced;
- there will be a system of automatic expiry with an opportunity to renew registration. Security interests in respect of consumer property and property described by serial number will automatically expire after 7 years. Security interests attaching to other forms of personal property will expire after 25 years;
- a new national computer based, internet accessible, security register to replace all
- there will be a system of voluntary registration of priority agreements which

will become known as subordination agreements;

- the new system will sit alongside of and will not replace the Consumer Credit Code;
- a system of “attachment” and “perfection” will clarify the concepts of the granting and registration and the timing of priority of competing interests;
- the law relating to acquiring ownership of personal property free of any security interest will be significantly improved by the new law;
- the law relating to retention of title to goods by an unpaid seller will become clearer. Every supplier of goods on credit is going to have to review its practises and contracts, to ensure compliance with the new law and to ensure that the retention of title is successful;
- the new rules will clarify enforcement processes and will include an obligation on the part of the secured party who is disposing of secured property to obtain the best price that is reasonably obtainable at the time of disposal;
- property acquired after the security interest is granted and further advances made after the security interest is granted will be expressly and more easily regulated by the new law.

(c) General comments

The significance of this reform is likely to be widespread. The complexity and expense of operation of the present law acts as a drag on the economy and is an impediment to the supply of finance to business and households.

There is a great deal of work for lawyers, accountants, lenders, insolvency practitioners and others to become familiar with the operation of the new law. The Government is proposing to adopt a 2 year transition period to enable everyone to get up to speed and to give time to enable existing security interests to be migrated to the new register.

Hopefully, those State governments who persist in charging mortgage duty (NSW and SA) will not

continue to do so, as the practice amounts to an impediment to the reform in those States.

Mark Smith

Email: mark@parrycarroll.com.au

Phone: +61 2 8257 3114

TAXATION LAW

**BUDGET ANNOUNCEMENT AS TO PROPOSED
TAXATION OF USE OF PROPERTY OR CHATTELS
HELD BY PRIVATE COMPANIES**

(a) Background

For various reasons, a private company may be the owner of real property or other assets which are used by either the company’s shareholder or the shareholder’s associate. Examples of such assets are the holiday home, the car or a boat. The reason why the company may have been chosen as the purchasing vehicle:

- to keep the asset out of the relevant person’s name;
- the company was the only source of funds to purchase the asset or to make the payments required to finance the purchase of such asset (and to avoid tax problems in purchasing the asset in another entity);
- the purchase was done in a hurry with no consideration being given as the correct entity that should make the purchase.

From a tax point of view, the tax liability on such arrangements arises if there is a “fringe benefit” (as defined in Section 136 of the *Fringe Benefits Tax Assessment Act*). No FBT liability arises if the benefit is provided to an individual in his or her capacity as a shareholder or an associate of such a shareholder.

Division 7A of the *Income Tax Assessment Act 1936* (“*Tax Act 1936*”) does not apply since the use by the shareholder or the shareholder’s associate of the asset in question is not a “payment” (as defined in subsection 109C(3) of the *Tax Act 1936*).

Thus, a private company could grant a shareholder or the shareholder’s associate use of its assets without adverse taxation consequences.

(b) Proposed changes

The 2009/10 Federal Budget announced that Division 7A of the *Tax Act 1936* will be amended, with effect from 1 July 2009, to cover the situation where a shareholder (or associate) is permitted to use the property or chattels owned by a company free of charge or at a discounted rate.

The purpose of the proposed amendment is to reduce the scope for private companies to allow their shareholders or associates to use company assets for less than an arm's length value. The way in which this is to be achieved is by deeming a "payment" (in terms of subsection 109C(3) of the *Tax Act 1936*) to be made to a shareholder where there is such use of company's assets so that a deemed dividend arises under Division 7A of the *Tax Act 1936*.

On 5 June 2009, Treasury released a discussion paper on the proposed amendments.

(c) Issues

Notwithstanding the discussion paper, a number of issues are still unresolved:

- how will the proposed changes apply to assets held by the trustee of a trust which is used by the relevant person? At present, Division 7A of the *Tax Act 1936* only applies to trusts in certain circumstances and, in particular, where the trustee makes a payment to a shareholder or an associate and a private company is presently entitled to income of the trust;

- where the benefit provided is also a "fringe benefit", will Division 7A have priority? At present, if an amount is a deemed dividend under Division 7A, there is no "fringe benefit" for the purposes of the *FBT Act*;
- will there be some type of concession where the user could have claimed an allowable deduction in relation to payments made for use? Under the *FBT Act*, there is the "otherwise deductible" exclusion in calculating the value of the fringe benefit.

The proposed amendments will cause considerable concern to these persons who have been using related entities to own assets for personal use. If the legislation applies, then consideration will have to be given to:

- paying a market value consideration for use of the assets;
- transferring the asset out of the entity.

Of course, the transfer of the asset out of the entity has other taxation consequences. These include the creation of a deemed dividend under Division 7A, capital gains tax and stamp duty consequences.

The proposed legislation is awaited with great interest.

Greg Ganz

Email: greg@parrycarroll.com.au

Phone: +61 2 8257 3111