

Liability limited by a scheme approved
under Professional Standards Legislation

November Newsletter

The partners of Parry Carroll are pleased to announce that Mark Smith has joined the partnership. Mark is a corporate commercial and finance specialist who has more than 30 years experience. Like the other partners at Parry Carroll, Mark has a high level of academic qualification. He has Bachelor of Laws and Master of Business Administration (Hons) degrees.

As well as adding depth to our existing strong commercial practice, Mark brings extensive new corporate and capital markets capabilities to Parry Carroll.

You can see Mark's profile at http://www.parrycarroll.com.au/people_smith.htm

COMMERCIAL

THE SHORT SELLING BAN – WHAT IS IT ALL ABOUT?

1. Background

There has been much recent publicity about the steps taken by international regulatory authorities and securities exchanges to prevent or limit the short selling of shares. What's going on?

How short selling works is best illustrated by an example. Mr Bear sells 100 shares in XYZ Ltd to Mr Bull for \$1 each. He agrees to deliver them in 1 week's time. Mr Bear does not own any XYZ Ltd shares when he makes the sale, but believes that he can buy the shares from someone else for \$0.95, before he has to deliver them to Mr Bull. He does this because he believes that the price is going to fall by the time he has to make his purchase. If he succeeds, Mr Bear will earn \$0.05 on each share sold and will earn a profit of \$5 on the 100 shares.

This traditional type of short sale is commonly called a "naked" sale. A more modern form of short sale is a "covered" sale, in which Mr Bear "borrows" the 100 shares from a third party before he enters into a sale agreement with Mr Bull.

There is considerable controversy about whether short selling has a good or bad effect on securities markets. There is no doubt that short sellers have an interest in the price of shares falling. The differences of opinion among regulators and commentators lies in the question of whether or not short sellers have the ability to bring about

falls in prices of shares. If there is a definitive answer to that question, it hasn't yet been universally accepted. Traders have been short selling shares since companies were first created approximately 400 years ago. Short sellers were accused of causing the 1929 Wall Street crash. Ever since then, there have been various forms of regulation of their activities.

2. Approach of regulators

The approach of many regulators has been to permit covered short selling in tightly controlled circumstance and to prohibit naked short selling. In recent weeks, the regulators have introduced temporary bans also on covered short selling. The Australian authorities, ASIC and the securities market operator ASX, have between them introduced a short term total ban and have announced that the ban will expire on 18 November 2008 for non financial shares and 27 January 2009 for financial shares (essentially lending banks and investment banks).

When the bans expire, and assuming there are no changes to the rules in Australia, it will again be possible for short sellers to undertake business. The Government has already announced that it will introduce legislation before the end of the year to more clearly define covered short selling, so we must expect some changes to the rules in Australia.

3. Current rules

The scheme of the current rules is to ban all forms of short selling except where a specific and

express exemption permits selling. The 5 current exemptions arise:

- in respect of shares in companies whose shares are listed on an ASX list of approved short sale products;
- in situations where the seller has made an arrangement to "borrow" shares for delivery to the buyer no later than 3 business days after the short sale occurs;
- in situations where the seller has made an arrangement to purchase sufficient shares from a third person i.e. covered the sale;
- where the seller is a specialist odd lot dealer who holds an appropriate financial services licence; and
- where the sale is part of an arbitrage transaction.

Where the transaction is of shares on the approved list or where the seller has borrowed the shares, the sale must be for a price which is the same or greater than the price at which the last reported sale of shares issued by the entity concerned took place. In other words, the sale can't be made in a falling market and, more importantly, the sale can't be used to drive the market down.

Where the transaction involves an arbitrage, or is one involving a prior borrowing arrangement or is a sale of a share from ASX's list of approved shares, the seller must report that sale as a short sale to ASX. The purpose of the reporting requirement is to assist ASX to ensure that the market is fully informed.

The list of entities that ASX has approved previously under its Market Rules, have one thing in common. They are all large entities. They are all entities with a market capitalisation of more than A\$100M and where ASX believes that there is a liquid market for the securities concerned.

One thing is for sure, it is going to take a while for the law and practice in this area to settle down.

Mark Smith

Email: mark@parrycarroll.com.au

Phone: 8257 3114

TAXATION

PROPOSED AMENDMENTS TO THE "SMALL BUSINESS CGT CONCESSIONS"

1. Background

The "small business CGT concessions", if they apply, have the effect of decreasing the otherwise assessable capital gain that arises on a CGT event to nil in the year of income of the CGT event.

However, under the current provisions, a taxpayer has difficulty in claiming the "small business CGT concessions" in the following circumstances:

- where the taxpayer owns property that is used by an "affiliate" or an entity "connected with" the taxpayer to carry on its business, and the other entity's ability to claim one or more of the "small business CGT concessions" is via the "\$2m aggregated turnover test";
- the taxpayer owns a CGT asset that is used in a partnership business and where the partnership business satisfies the "\$2m aggregated turnover test"; and
- where a taxpayer deferred the remaining capital gain under subdivision 152-E but wishes to claim the "small business retirement exemption" under subdivision 152-D in two years time. The problem is in two years time, the taxpayer has, again, to satisfy the "basic conditions" at that time, and, in particular, the net asset value of the taxpayer's assets together with assets of other relevant entities must not exceed \$6m.

On 14 October 2008, the Treasury released the Exposure Draft to *Tax Laws Amendment (2008 Measures No.7) Bill 2008* that deals with the above problems.

2. Proposed amendments

- (a) Assets held by taxpayer used by an "affiliate" or entities "connected with" the taxpayer to carry on its business

Under the proposed amendments, the taxpayer is taken to carry on the business carried on by the taxpayer's "affiliate" or by the entity "connected with" the taxpayer. In a practical sense, this means that if the "affiliate" or entity "connected

with" the taxpayer satisfies the "\$2m aggregated turnover test", the taxpayer can satisfy this test so as to be eligible to claim one or more of the "small business CGT concessions".

(b) Assets held by taxpayer which is used by the partners of a partnership to carry on their business

Under the proposed amendments, the taxpayer who owns the asset and who is a partner of the partnership is taken to carry on the business of the partnership. In practical terms, this means that if the partnership satisfies the "\$2m aggregated turnover test", the taxpayer as a partner can satisfy that test so as to be eligible to claim one or more of the "small business CGT concessions".

(c) Claiming "small business retirement exemption" after deferral of capital gain under subdivision 152-E

Under the proposed amendments, the "basic conditions" do not have to be satisfied when the taxpayer wishes to utilise the "small business retirement exemption" after deferral of the capital gain under subdivision 152-E.

In practical terms, this means that since the taxpayer satisfied the "basic conditions" at the time of the original CGT event (e.g. the sale of the assets of the business), the requirement to either pay the taxpayer the relevant amount (if the taxpayer is over the age of 55) or to roll the amount into a complying superannuation fund (if the taxpayer is under the age of 55) can take place notwithstanding:

- there may be no "active asset" at the relevant time; and
- the "net asset value test" may not be satisfied at the relevant time.

The requirement that the taxpayer does not have to satisfy the "net asset value test" at the relevant time is significant. In particular, when the original asset was sold, the relevant "net asset values" may have been close to \$6m. After two years, there is a very strong likelihood that the "net asset value" has exceeded \$6m. Under the proposed amendments, a taxpayer no longer has to be concerned as to any increase in the "net asset value".

3. Planning opportunities

There are considerable planning opportunities to ensure that the small business CGT concessions are available. From practical experience, the issues that need to be looked at are:

- the satisfaction of the "net asset value test" or the "\$2m aggregated turnover test";
- the ability to rollover a superannuation contribution to the trustee of a complying superannuation fund after the remaining capital gain has been deferred under subdivision 152-E.

Greg Ganz

Email: greg@parrycarroll.com.au

Phone: 8257 3111

PROPERTY GST ON DEPOSITS

Transaction lawyers are still working through the consequences of the recent High Court decision in *FCT v Reliance Carpet Co Pty Ltd* [2008] HCA 22 which held that GST applies to a forfeited deposit (where the vendor is registered or required to be registered for GST and the sale is part of an enterprise carried on by the vendor).

The most immediate result is that where a contract is forfeited in those circumstances, the vendor must pay one eleventh of the traditional 10% deposit to the ATO as GST (and, if registered, the purchaser may be entitled to a tax invoice, together with an input credit for that one-eleventh portion).

Whilst some contracts now require the purchaser, on default, to reimburse the GST, it is unlikely that such amounts will be paid where the purchaser is already in default and the deposit has been forfeited.

Some lawyers have considered increasing the deposit amount to 11% of the GST exclusive price. However, this may not be effective as the Courts sometimes view the forfeiture of a deposit in excess of 10% as a penalty or an instalment payment.

If GST is payable on the sale, then the preferred alternative is for a vendor to express the price as inclusive of GST, and to then require a deposit of 10% of that GST inclusive price.

While the market is still working through the consequences, the current practice appears to be that in the case of sales not liable to GST (eg supply of a going concern), a deposit of 10% is still paid even though the value of that deposit may be reduced if that contract is terminated.

The case and its application will not be relevant for purchasers of residential property from unregistered vendors, as GST will not apply to forfeiture by vendors not registered for GST.

Selwyn Black

Email: selwyn@parrycarroll.com.au

Phone: 8257 3113
