

## September 2003 Newsletter

*This newsletter deals with potential traps in the small business retirement CGT concession, guarantor's liability on a variation of lease together with proposed changes to the laws dealing with powers of attorney.*

### TAXATION LAW

#### AVAILABILITY OF SMALL BUSINESS CGT RETIREMENT CONCESSION

##### (a) Background

Where a taxpayer sells an asset that was acquired after 20 September 1985 ("post CGT"), there are potentially two CGT concessions available:

- the "discounted capital gain" concessions under Division 115 of the Income Tax Assessment Act 1997 ("*Tax Act 1997*"); and
- the small business CGT concessions under Division 152 of the *Tax Act 1997*.

This article deals with the retirement concession, which forms part of the small business CGT concessions.

For any of the small business CGT concessions to apply, the "basic conditions" must be satisfied (Section 152-10). In practice, this requires that the net asset value of the taxpayer and related parties is less than \$5m and the asset in question is an "active asset".

If the basic conditions are satisfied, an automatic 50% exemption can be claimed on

either the capital gain (if there is no "discounted capital gain" concession) or the remaining capital gain (if there is a "discounted capital gain" concession).

The question then arises whether further CGT concessions can be claimed under the small business CGT concessions. One of those concessions is the retirement concession found in subdivision 152-D.

##### (b) Terms of retirement concession

Where the taxpayer selling the asset is an individual, the terms of the "retirement concession" are relatively easy to satisfy. In essence, there is no need for the individual to retire and up to \$500,000 of the capital gain can be disregarded. If the individual is under the age of 55, the amount must be rolled over to the trustee of a superannuation fund.

Where the taxpayer selling the asset is a company or a trustee of a trust, things become more difficult. Firstly, those entities must satisfy a test known as the "controlling individual test". Secondly, an "eligible termination payment" ("etp") must be made to persons who are "CGT concession stakeholders".

The etp requirement has been subject to two recently released ATO Interpretive Decisions. In the first of those decisions, ID 2003/743,

the question raised was whether any part of the \$500,000 would be considered a deemed dividend under subsection 109(1) of the *Income Tax Assessment Act 1936* on the basis it was “unreasonable”. On the facts stated in ID 2003/743, the ATO came to the conclusion that the payments were “reasonable”.

The second ATO Interpretive Decision, ID 2003/748, confirms that in order for the payments to be an etp, there must be a termination of employment with the company or the trustee of the trust. The ID confirms that “employment” includes the holding of an office and that the retirement requirement will be satisfied if the person resigns either as an employee or as a director.

The two ATO IDs confirm that considerable care needs to be taken in applying the “retirement” small business CGT concession.

**Greg Ganz**

**Email:** [greg@parrycarroll.com.au](mailto:greg@parrycarroll.com.au)

**Phone:** 8257 3111

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## PROPERTY LAW

### GUARANTOR’S LIABILITY ON A VARIATION OF LEASE

In the NZ Case of *Overton Holdings Ltd v Owens Properties Ltd*, the lessor leased a large commercial property to a lessee company for 12 years. Owens Properties Ltd guaranteed the lessee’s obligations. The lease required the Lessor to insure all buildings for their full replacement value in the joint names of the Lessor and the Lessee. The guarantee clause contained the following provision:

Each of the Guarantors covenants with the Lessor that each of them will duly and punctually pay all rent interest and other moneys now or hereafter payable pursuant to

the within Lease or any renewal or variation thereof..... and the variation of this Lease (including pursuant to any rental review) shall not exonerate or release any of the Guarantors from their liabilities hereunder” [emphasis added]

About 10 years into the lease, the lessor sold its interest in the property subject to the lease to Overton Holdings Ltd. Overton Holdings Ltd and the tenant entered into a deed varying the lease with the result that insurance was to be arranged by the lessee for the indemnity value instead of replacement value. The guarantor was not informed of that alteration, nor was its consent sought.

A year later the lessee vacated the premises and soon afterwards a fire and vandals caused substantial damage to part of the building. The lessor sought to recover from the lessee the cost of reinstating the premises, which was assessed at arbitration. The lessee was placed in liquidation and the lessor sought to recover the amount from the guarantor.

The NZ Court of Appeal held that a variation of the lease without the guarantor's consent had the effect of releasing the guarantor from its liability. This was so despite the wording of guarantee stating that the guarantee still applied where there was a variation of the lease. The Court also held that the arbitration award, to which the guarantor was not a party, could arguably not be enforceable against the guarantor.

The NZ Court of Appeal’s decision is a reminder that despite the wording of a guarantee in a lease, any alteration of a provision of the lease should only be made with the guarantor's knowledge and consent. Otherwise the lessor runs the risk of the guarantor being released from its obligations under the guarantee.

**Peter Carroll**

**Email:** [peter@parrycarroll.com.au](mailto:peter@parrycarroll.com.au)

**Phone:** 8257 3186

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## GENERAL LAW

### CHANGES TO THE LAW OF POWER OR ATTORNEY

Draft legislation is being prepared which will significantly change the law relating to powers of attorney.

The following proposed changes are of special interest:

- When using the statutory short form of power of attorney, the authority for the attorney to take a benefit can be given in general terms, to cover the attorney's reasonable needs and medical care, but all other benefits must be clearly identified by the principal.
- The proposed statutory short form of power of attorney does not give the attorney the right to provide a benefit to a third party unless such right is expressly included by the principal. In addition, the right may be given in general terms where it relates to the third party's reasonable living and medical needs, but all other benefits must be clearly identified by the principal.
- The proposed statutory short form of power of attorney does not give the attorney the right to make gifts from the principal's estate unless the principal expressly includes such right.
- An attorney will be required to endorse his or her acceptance of the appointment on an enduring power of attorney.
- Provision will be made for recantation of powers of attorney made interstate.

- A specific gift in a will is protected from an act of ademption by an attorney who is acting under an enduring power of attorney while the principal does not have mental capacity. This will ensure that any funds left over from the sale of the gift are available to the legatee.
- The jurisdiction of the Guardianship Tribunal will be expanded to allow it to adjudicate and provide directions on powers of attorney, declare that a person no longer has mental capacity, vary or revoke powers of attorney and make other orders relating to powers of attorney.

These changes are presently incorporated in the Power of Attorney Bill 2002, which is in its 6<sup>th</sup> draft but has not yet been gazetted.

**Ross MacDonald**

**Email:** [ross@parrycarroll.com.au](mailto:ross@parrycarroll.com.au)

**Phone:** 8257 3133

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