

## This Edition

- 3 Stamp duty amendments affect leasing arrangements
- 5 Don't under pay your pensions
- 5 Business sector teams offer more value to clients
- 6 Events to watch out for...

# What exactly is an Unfair Preference?

**Uncommercial transactions, unfair preferences, clawback provisions, voidable transactions...wait, stop, don't go – this isn't a foreign language but the language of the LIQUIDATOR!**

To make sense of Liquidator-speak would require a detailed understanding of the Corporations Act 2001 (the Act) and case law. In this article, we will provide you with a brief understanding of the term 'unfair preference' and why it is important to you.

In these tough economic times, it is not uncommon for your clients to be receiving part payments or requests to provide indulgences in respect of outstanding accounts. Both you and your client need to be mindful of the implications for accepting these part payments and of granting indulgences should the debtor be placed into liquidation.

### Must you pay on a Liquidator's demand?

A Liquidator has the ability to 'clawback' (take back) payments that are considered to be 'unfair preference' payments (Unfair Preference). It is important to note from the very outset, that the Act only makes these transactions **voidable**. What this means is that a Liquidator does not have an automatic right to recover these payments if the creditor refuses to pay the demand of the Liquidator – the Liquidator must then obtain a Court Order requiring payment. Often however, Liquidators receive a payment from a creditor by negotiating a settlement without obtaining a Court Order.

### What must a Liquidator prove?

For a Liquidator to be successful in an Unfair Preference claim the following **MUST** be proven by the Liquidator:

- The company (in liquidation) and the creditor(your client) are parties to the transaction;
- The transaction(s) took place within six months before the commencement of the winding up (extended to four years if related parties are involved);
- The payment is made by the company when it was insolvent or became insolvent because of the transaction(s); and
- The payment(s) resulted in the creditor receiving more than they would have in a liquidation scenario.

### What are the defences available?

Even if the Liquidator has proven the matters referred to above, the Act provides a creditor with defences to claims of Unfair Preference. To obtain the benefit of the defence, your client must prove:

- It became party to the transaction in good faith;

→ *continued page 2*



## What exactly is an Unfair Preference? (continued)

- At the time it became party to the transaction, it had **no reasonable grounds for suspecting the company was insolvent** or would become insolvent as a result of the transaction; **AND**
- It provided valuable consideration as part of the transaction (ie the payment was received in return for goods or services provided).

### Continuing Business Relationship – a phrase to remember

If your client has received a payment(s) within the relevant period which appears to be an Unfair Preference, you can potentially mitigate the extent of your client's exposure by considering whether your client's receipts from the company in liquidation could be considered a part of a continuing business relationship.

Under the Act, where a transaction 'payment' is for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the Company and in the course of the relationship, the level of the Company's net indebtedness to the creditor is increased and reduced from time to time as a result of a series of transactions forming part of the relationship, then all the transactions forming part of the relationship are to be treated as if they together constitute a single transaction. This means that where there is, for example, a running account balance between your client and the insolvent debtor (the Company in liquidation) so that, for example, during the relevant period a series of payments are made by the insolvent debtor to your client and your client provides a number of deliveries of goods or services, the unfair preference may only be taken to have occurred if the value of the payments received by your client during the relevant period was greater than the value of the goods or services delivered by your client to the insolvent debtor during the relevant period.

*An example will help to show you how the continuing business relationship principle works.*

*Let's assume that the balance of the debt owed to your client at the date that is six months prior to the date of the liquidation is \$100,000 and that during the period between that date and the commencement of liquidation, goods and/or services were supplied by your client to the company in liquidation and payments were made by the company in liquidation (and received by your client) for the amount of \$29,000. In the absence of the "running account" principle which is derived from a 'continuing business relationship', the client would be vulnerable to a claim by the liquidator of an 'unfair preference' in the sum of \$29,000. As the example below indicates, where there is a "continuing business relationship, the 'preference' claim must take this into account as follows:*

Continuing Business Relationship – how it works:				
				\$
			Balance owing to creditor at the start of relevant period	100,000
Transactions for the six months from the Liquidator's appointment	15 January 2010	Invoice	10,000	110,000
	20 January 2010	Invoice	15,000	125,000
	15 February 2010	Payment	(9,000)	116,000
	16 February 2010	Payment	(20,000)	96,000
	16 March 2010	Invoice	7,500	103,500
<b>Straight unfair preference argument (all payments)</b>				<b>(29,000)</b>
Continuing Business Relationship / Running Account				
Total Payments			(29,000)	
Total Goods received			32,500	3,500
Creditor is owed more money, than at the start of the 'continuing business relationship' therefore, no preference!				

### How it Works: Characteristics of an Unfair Preference?

In determining if there are any transactions which constitute an Unfair Preference, a Liquidator will examine the Company's records. The Liquidator will look for evidence that the creditor (your client) had reasonable grounds for suspecting that the company was insolvent or that your client did not act in good faith. In particular, a Liquidator will look for:

- Payments that appear to be outside the normal trading terms;
- Threats of stop supply / actual stopping of supply;
- Legal recovery action having been commenced;
- Lump sum payments having being made, and
- 'Round' dollar amounts.

### To accept the payment or not to accept the payment?

At the end of the day, it is always better for the money to be in your client's pocket. As we have tried to show in this article, initially the onus will be on the Liquidator to prove various elements of a potential Unfair Preference. Even if the Liquidator is able to prove that elements of an Unfair Preference exist, your client will still have the ability to rely on the defences provided under the Act before conceding to a Liquidator's request.



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# Stamp duty amendments affect leasing arrangements

**The amendments to the Duties Act 2000 (Vic) ('the Act') in relation to leasing arrangements have now become law and apply with retrospective effect from 21 November 2008.**

## Transactions subject to Duty

The following transactions in relation to leases of land in Victoria are now potentially subject to duty:

- (a) The granting of a lease of land for which any consideration other than 'rent reserved' is paid or agreed to be paid in respect of the lease;
- (b) The granting of a lease of land for which any consideration other than 'rent reserved' is paid or agreed to be paid in respect of any right or option for a sale or transfer of the land, or any other arrangement by which the lessee obtains any right or interest in the land other than the leasehold estate;
- (c) The transfer or assignment of a lease of land for which any consideration is paid or agreed to be paid;
- (d) The transfer or assignment of a lease for which any consideration is paid or agreed to be paid in respect of any right or option for a sale or transfer of the land, or any other arrangement by which the lessee obtains any right or interest in the land other than the leasehold estate; and
- (e) The surrender of a lease that is dutiable property pursuant to any of (a) to (d) above.

The State Revenue Office ('SRO') has provided some guidance on its website on how it will administer the new provisions ('SRO's Lease Guidelines'). The SRO has also issued Draft Revenue Ruling DA 01-10 ('the draft SRO ruling'), which deals with the meaning of 'rent reserved' for the purposes of the amendments.

## SRO'S Lease Guidelines

While the SRO's Lease Guidelines seem to indicate that the SRO will take a practical approach to the administration of the new lease provisions, it should be noted that the guidelines are not binding on the SRO and a strict reading of the amendments would result in certain transactions being technically dutiable under the Act, even if the SRO could decide not to impose duty.

## Some inconsistencies

- Under the Act where there is a grant or assignment of a lease and consideration has been paid or agreed to be paid in relation to a right or option to acquire the underlying land, duty must be paid within 3 months of the grant or assignment of the lease irrespective of whether the right or option has been exercised.

However, the SRO's Lease Guidelines provide that where additional consideration equivalent to the full unencumbered value of the land is required to be paid upon, or following the exercise of the right or option, the SRO will only require payment of duty when the right or option is exercised (and not when the lease is granted or assigned). The rationale behind this is that the lessee does not acquire valuable rights to the land equivalent to ownership upon the grant or assignment of the lease, and will only do so upon the exercise of the right or option and payment of the full amount equivalent to the unencumbered value of the land.

In all other cases, where less than the full unencumbered value of the land is payable on the exercise of the right or option, duty will be payable at the time of the grant, transfer or assignment of the lease.

- The SRO's Lease Guidelines provide that no duty will be payable where a standard commercial lease is assigned for nominal consideration as part of a bona fide sale of a business which is conducted on the leased premises.

Again, this is inconsistent with the Act which provides that a transfer or assignment of lease for which 'any' consideration is paid is a dutiable transaction, with duty payable on the full unencumbered value of the underlying land.

The two examples above are indicative of the differences between the amendments themselves and the approach the SRO is taking in administering the amendments.

## Upfront Payment

The SRO's Lease Guidelines confirm that each time an upfront payment is made in relation to a lease, a determination must be made whether the payment is 'rent reserved' based on the facts and circumstances.

The draft SRO ruling on rent reserved provides that the Commissioner, in determining if an upfront payment is rent reserved, will consider the nature and circumstances of the transaction as a whole, including the value of the underlying land the subject of the lease. Another factor that the Commissioner will consider is whether the upfront payment represents the net present value of a bona fide market rental over the term of the lease that is not referable to the value of the freehold, which would indicate that it is rent.

The amendments are so wide in their application that we must now depend upon the discretion of the SRO to examine the nature and circumstances of the transaction as a whole, in order to determine whether the lease arrangement was structured to effectively transfer the rights in the underlying land and/or economic benefits of the land.

As such, it is important to determine whether there is consideration and whether the consideration is 'rent reserved'.



## Consideration

In terms of whether consideration is paid or agreed to be paid, note the following:

- The SRO has confirmed that the definition of consideration is wide and includes the provision of non-monetary consideration;
- One example of non-monetary consideration in a lease context is covenants given by a lessee to a lessor under the terms of a lease. Where a lease requires a tenant to undertake structural work, construct improvements or undertake a tenancy fit out and the improvements become the property of the lessor at the end of the lease, the value of the improvements can be regarded as consideration for the purposes of the amendments;
- Conversely, where a tenant is required to fit out a leased premises and the fit out does not become the property of the lessor at the conclusion of the lease term, the SRO will not consider this to be consideration. Similarly, the SRO's Lease Guidelines confirm that a make good payment will not be viewed by the SRO as consideration.

The SRO has indicated that it is in the process of developing a ruling which will provide guidance on when consideration is provided in the context of the lease provisions.

## Rent Reserved

Under the lease transactions listed at (a) and (b) above, where consideration other than rent reserved is paid or agreed to be paid in relation to the grant of a lease, the lease will potentially attract stamp duty.

In clarifying what constitutes rent reserved, the legislation provides some examples, such as rates, charges, taxes, maintenance, utilities, certain legal costs, insurance premiums, marketing costs and car park contributions.

The SRO's Lease Guidelines and the draft SRO ruling confirm that the items listed in the legislation are not exhaustive and are only illustrative of the types of payments that would be considered to be rent reserved. In addition, the SRO's Lease Guidelines and the draft SRO ruling confirm that the following may also be classified as rent reserved:

- A bond or guarantee paid by a lessee to a lessor to secure the lessee's obligations under the lease, including 'make good' payments;
- Amounts paid by a lessee to a lessor in respect of the installation or upgrade of services and utilities (such as gas, water, telephone, electricity);
- Contributions to expenses pertaining to the maintenance of common areas;
- Promotional levies and security costs; or
- Other costs required to be paid by the lessee on behalf of the lessor in relation to the grant of the lease.

The draft SRO ruling provides that in determining whether any other payment falls within the definition of rent reserved, the Commissioner will have regard to the nature, size and frequency of the payment.

Due to the wide discretion now conferred on the SRO and the fact that both the SRO's Lease Guidelines and draft SRO ruling are not binding on the SRO, where a lease arrangement is contemplated and a payment of consideration (either monetary or non-monetary) is made that could potentially be regarded as something other than 'rent reserved', to the issue of whether duty may be payable should be considered.

If duty is payable, it is payable at transfer rates on the greater of the consideration and the unencumbered value of the underlying land. Accordingly, it is important to seek advice on the stamp duty status of any lease of land in Victoria of a type referred to in this article.



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# Don't under pay your pensions

## What was reported

In a recent Industry Liaison Group meeting the Australian Taxation Office (ATO) said that a superannuation fund that paid less than the required minimum pension to a member in a year would lose its tax exemption on that pension for the whole of that financial year. This view was reported in the press.

When a superannuation fund commences to pay a pension, income arising from the assets held to pay the pension becomes exempt from tax. The ATO essentially argues that paying a minimum pension each year is an essential requirement of a pension as defined in the *Superannuation Industry (Supervision) Act.1993('SIS')*. If the minimum pension is not paid, the fund has not paid a pension, as defined, and the fund is therefore not entitled to a tax exemption for the year.

**We are not convinced that this view is correct.**

## A different interpretation

Section 295-385 of the ITAA 1997 says that income and capital gains arising from segregated current pension asset will be exempted from tax in the superannuation fund. Section 292-390 deals with unsegregated current pension assets, but works in the same way as Section 295-385.

Segregated current pension assets are assets held to enable the fund to discharge all or part of its liabilities in respect of a superannuation income stream benefit. If you work your way

through all the definitions, you find that a superannuation income stream benefit is a pension as defined in SIS.

A pension is an ongoing superannuation benefit. The superannuation fund holds assets to allow it to meet its liability to pay a pension to its member. The assets are held not just to meet the liability for the current year's pension, but for all future years pensions as well. Arguably the fund trustee also has a liability to pay out any residual assets on the member's death.

At any given time only a comparatively small portion of the assets held to support a pension are held to meet the current years pension liability. This is particularly so in earlier years of the pension. As such, the majority of assets held to fund the pension are held to meet the funds liability to pay a pension to the member in future years.

## The tax exemption: the implied assumptions

The tax exemption applies to income and capital gains arising from all current pension assets, whether they are used to meet this year's pension liability or intended for future years. In providing this tax exemption, the Government has two implied underlining assumptions:

- That the fund will in fact go on to pay a pension in future years; and
- That the fund will pay a pension that meets one of the pension definitions in the SIS Act in future years.

These assumptions should apply to a fund that fails to pay a minimum pension this year as much as they do to a fund that pays at least the minimum. There is no reason to assume that because a fund under pays the pension this year, it will do so in all subsequent years. In fact, the opposite is more likely to be true.

## Our conclusion

We must therefore conclude that even when a fund fails to pay the minimum pension this year, they are still holding current pension assets in respect of future pension liabilities and are still entitled to a tax exemption in respect of those assets.

The ATO may be able to argue that a portion of the current pension assets that equates to the amount of this years pension should not be eligible for a tax exemption, but the amount held to meet future pension liabilities are still validly current pension assets and validly entitled to the exemption from tax.

## Our actions

We have written to the ATO setting out our view on this matter but have not yet received a response. We will keep you informed of relevant developments.



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# Business sector teams offer more value to clients

Pitcher Partners Melbourne has a range of dedicated business sector teams which serve as hubs for sharing industry focussed knowledge and experience. These multifunctional teams combine skills and experience from across the firm and seek to offer clients complete business solutions.

Our business sector teams include:

- **Property & Construction**
- **Professional Services (Legal, IT, Engineering etc)**
- **Funds Management**
- **Agribusiness**
- **Retail, Supply & Hospitality**
- **Transport & Logistics**

CPN members with clients requiring specialised advice should contact Gess Rambaldi on 03 8610 5144, who can refer your client to one of our business sector teams for assistance.

# Events to watch out for...

## Breakfast Briefing – FBT Update

Thursday 29 April at Pitcher Partners Level 19, 15 William Street, Melbourne 7.15am for a 7.30am start and 9.00am conclusion.

Cost \$40 members, \$60 non-members (GST inclusive).

## Asset protection for professionals in public practice – the roadshow keeps on going on!

Gess and Andrew hit the road again. Gess Rambaldi and Andrew Yeo are well into a 'roadshow' of breakfast presentations to CPN members in metropolitan Melbourne, regional Victoria, regional NSW and Tasmania. CPN members have turned up in great numbers to participate in briefings held in their areas.

Professionals in public practice should have legal and prudent asset protection strategies. These sessions are a must for anyone interested in legally protecting wealth. The relevance and interest in this topic is evidenced below in some of the feedback we have had from members:

*"The best seminar I have attended so far - simple/easy to understand."* Alan Mitchell of Mitchell Partners

*"Excellent seminar – clear and concise."* Wendy Maitland-Smith of Maitland-Smith and Associates

*"This is one of the most succinct and relevant seminar presentations I have attended. Andrew and Gess worked very well together."* Tom Pender of Pender & Associates

Please note that two extra dates in Tasmania and dates in Wagga Wagga and Mildura have been added to this list which was originally published in the Summer issue last December.

Dandenong – 25 March  
Preston – 26 March  
Shepparton – 15 April  
Wangaratta – 16 April  
Glen Waverley – 20 April  
Albury – 22 April  
Wagga Wagga – 23 April  
Hobart – 6 May  
Launceston – 7 May  
Mildura – 13 May

If you haven't yet signed up for a presentation, please telephone Anna Beech on (03) 8610 5144.

## Professional Advisors' Conference – Friday 14 May

The Professional Advisors' Conference has moved! This May we will be hosting the Critical Point Network Professional Advisors' Conference at the new Melbourne Convention Centre located at Melbourne's newest precinct, South Wharf. The Melbourne Convention Centre is just a short stroll from Southern Cross Station and also has plenty of parking available.

We hope you enjoy this new venue. More details to follow.



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