

*Happy new year!*

\*\*\* WE HAVE MOVED \*\*\*

Our new contact details are as follows:

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*(Our PO Box remains the same)*

Our new phone & fax numbers are:

	Old	New
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### Liability for directors of corporate trustees

The **Corporations Amendment Bill (No 1) 2005** received Royal Assent on 18 November 2005 as Act No 118 of 2005, clarifying the scope of the potential personal liability for directors of corporate trustees, following the decision in *Hanel v O'Neill* [2003] SASC 409.

#### *Hanel v O'Neill*

In *Hanel v O'Neill* [2003] SASC 409, the Full Court of the South Australian Supreme Court extended the circumstances in which a director of a corporate trustee company could potentially be held personally liable under s 197(1) of the *Corporations Act 2001*. As a result of this decision, directors of corporate trustees were regarded as effectively guaranteeing trust liabilities, in the event that there were insufficient assets to meet these liabilities. The Government considered that this decision unfairly exposed directors of corporate trustees to increased potential personal liability: see 2005 WTB 25 [1020].

#### Liability of directors of corporate trustee

To address the situation, the Bill replaces the existing s 197(1) of the *Corporations Act 2001* with a new s 197(1) that unambiguously only imposes personal liability on a director of a corporate trustee where the corporation's right of indemnity as trustee is lost through disempowering conduct on the part of the corporation (whether through breach of trust or *ultra vires* conduct) or through a restriction in the terms of the trust that purports to deny a right of indemnity against trust assets.

In particular, a director of a corporate trustee will be liable to discharge the whole or a part of a liability incurred by the corporate trustee, which the corporation is unable to discharge, or has not discharged, where the trustee is not entitled to be fully indemnified against the liability out of trust assets because one or more of the circumstances applies:

1. where a trustee corporation has acted in breach of trust and the conduct relates to the incurring of the liability by the corporation;
2. where the corporation has acted outside the scope of its powers (*ultra vires* the terms of the trust) as trustee; and/or

3. where there is a term in the trust deed denying, or limiting, the corporation's right as trustee to be indemnified against the liability.

Therefore, where the corporate trustee cannot discharge a particular liability incurred by it, and where one or more of the 3 sets of circumstances applies, the indemnity is displaced and the trustee is not entitled to be fully indemnified out of trust assets. In those circumstances, the directors will be personally liable (both individually and jointly with the corporation and any other relevant person) to discharge the liability (subject to s 197(2)).

#### Date of effect

The amendments commenced on Royal Assent, i.e. 18 November 2005

### Primary production activity and impact of drought

#### Question

*My client, a plumber, purchased a grazing property some 3 years ago and has plans to establish an angora goat stud and give away his plumbing business. The property was purchased with a herd of about 50 cattle. However due to drought conditions he has had to put these plans on hold and in the last 2 years, due to poor pasture conditions, has had to dispose of 50% of the existing livestock. In addition, he has had to continue his plumbing business in order to ensure that he has a cash flow to continue making payments on the farm. Currently the property is not in an area that has been officially declared to be in drought. Will the non-commercial loss provisions apply to my client and what are the tax implications of the sale of the livestock?*

#### Answer

Generally, under the non-commercial loss provisions in Division 35; a taxpayer will not be able to offset a loss from a non-commercial activity against other income unless one of 4 tests is satisfied. These tests are that the business activity must:

1. Have assessable income of at least \$20,000;

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2. Have produced a profit in 3 out of the past 5 years; **including the current year.**
3. Use real property or an interest in real property worth at least \$500,000 on a continuing basis; or
4. Use other assets worth at least \$100,000 on a continuing basis.

However, in certain circumstances, the Commissioner may exercise a discretion not to apply the provisions where the business would have satisfied the tests contained in the Division apart from special circumstances such as drought, flood or bushfires.

A taxpayer who has failed all 4 tests as a result of special conditions, needs to ask the Commissioner to exercise the discretion under [s 35-55\(1\)\(a\)](#) and the request should be made as soon as possible after the circumstances have occurred (eg in the first year in which the drought conditions affect the business). In the case of a business affected by drought, the taxpayer needs to provide evidence of a period of below normal rainfall in the area in which the activity is located. The taxpayer also has to provide evidence that the activity would have passed one of the tests but for the drought. For example, evidence of past years profit and loss figures, a business plan for the proposed activity and evidence of the impact of the drought on other operations in the area in the same industry.

Where the Commissioner exercises his discretion it may in certain circumstances be exercised for more than 1 year. Otherwise the taxpayer will have to apply on an annual basis (where the circumstances continue).

Where the taxpayer has had to dispose of livestock because of low fodder levels, [s 385-95\(1\)](#) enables an election to be made to spread the profit of the disposal over 5 years where the disposal occurs because pasture or fodder is destroyed by fire, drought or flood. In order for an election to be made under this section it is not necessary for there to be an official acknowledgment of drought by a competent authority. It is sufficient for there to be evidence that the property was in fact drought affected and that those conditions caused the disposal of the livestock. See ATOID 2002/780.

### Whether co-ownership of property a partnership

#### Question

*A husband and wife partnership own 23 residential rental properties as tenants in common. They actively manage these rental properties collecting the rent, paying all outgoings, attending to collection and lodgement of bonds, making regular inspections, providing ongoing maintenance etc. The wife prepares the books of account for each property.*

*Are the taxpayers required to lodge a separate partnership return instead of adding rental schedules to their personal income tax returns, on the basis that they are operating a rental property business in partnership?*

#### Answer

A taxpayer will be regarded as a partner at general law if the partnership is carrying on a business. Generally, a taxpayer who derives income jointly from one or two rental properties will not be regarded as carrying on a business: see Ruling TR 93/32. However, there may be situations where the scale of the activities is such that there is a business. In Ruling TR

93/32 the Tax Office states that "if rent was derived from a number of properties or from a block of apartments, that may indicate the existence of a business."

Where there is a business, the taxpayers may be regarded as having a partnership at law (rather than a partnership for taxation purposes). The other factors that the Tax Office will consider in making such a determination are set out in Taxation Ruling TR 94/8. These include: 1. The mutual assent and intention of the parties; 2. Joint ownership of business assets; 3. Joint business account and the power to operate it; 4. The extent to which the parties are involved in the conduct of the business; 5. The extent of capital contributions; 6. Entitlement to a share of net profits; 7. Business records; 8. Trading in joint names and public recognition of the partnership.

Given the number of rental properties jointly owned by the taxpayers, it is more likely that they are carrying on a business in partnership (although the various factors listed above should still be considered). If they are deemed to be a partnership at law, the taxpayers will need to lodge a partnership return, showing the net income of the partnership and the distribution of income. The net income must then be distributed in accordance with the partnership agreement.

**Speak to your Abacus contact for more information on anything contained in this newsletter. Either for clarification, further information or to see how a particular item could be applicable to your situation. Call (03) 9655 3900**

#### Quote of the Month

There are two kinds of people in the world: those who make excuses and those who get results. An excuse person will find any excuse for why a job was not done, and a results person will find any reason why it can be done. Be a creator, not a reactor. -- **Alan Cohen, A Deep Breath Of Life**