THE ARGYLE PARTNERSHIP
LAWYERS

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THE END IS NIGH

Should we beware the Ides of March?

As 11 March 2004 approaches, some are beginning to panic. Financial Service Reform has been on the horizon for the last two years, but now it is only weeks away and fear has gripped some. Let's be clear on our answers to these questions; does the world come to an end (and a new FSR one begin)? Only if you want it to. Beware the Ides of March? Yes, and embrace the opportunity.

Some see the approaching Ides of March (or to be correct, a few days before) to be the perfect opportunity to get that tax saving corporate vehicle in place. This has then raised one of the most perplexing issues of the moment; what is the nature of the new dealer/rep relationship and what can it look like? And from this comes the question; must the dealer/rep relationship be restructured and a new agreement be written?

In most cases, the answer is no, a new dealer/rep agreement does not need to be written. Sure the old one can be updated into 2004 FSR language, but that is all that is needed. In fact at law, there is no need for an agreement at all. FSR only requires the AFSL to have in place a written authorisation for each authorised representative (AR). Section 916A of the Corporations Act ("the Act") merely requires that a licensee authorises the AR in "writing". The Act does not require an agreement to provide such authorisation.

Of course, this is only the minimum law. You can have an agreement if you want it, and it is recommended that you do so that everyone knows what everyone else is meant to do, when and for how much.

So what form of relationships can exist post FSR? All of them, and two more. There is no need for change, all of the pre FSR relationships can continue. All that has changed is that FSR now allows for a corporate AR. There are four approaches to authorisation in the post FSR financial service world;

1. The individual is appointed an AR directly by the AFSL under section 916A.

2. Following a nomination by another (often a company, trust or partnership with whom the AFSL will have a "distribution or licensing agreement") an individual is appointed an AR directly by the AFSL under section 916A.

3. The company is appointed an AR directly by the AFSL under section 916B followed by a sub authorisation of a person by the corporate AR, subject to the written consent of the AFSL.

4. The company is appointed an AR directly by the AFSL under section 916B and a subsequent authorisation of a person nominated by the corporate AR is made directly by the AFSL under section 916A.

The first two approaches to authorisation have existed since the beginning of financial services in Australia. And these continue post FSR!

So if you don't have to change, should you? I don't know, what do you want to achieve under a new

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business structure that you could not achieve under your old structure?

Some believe that taxation advantages will emerge. But how can this be? If the people involved, the nature of the business and the business activities do not change, there is no chance for tax advantages to arise.

If the representative was the directly appointed proper authority holder deriving the commission, trail or service fees, changing to a corporate AR will, without anything further, achieve no taxation advantages. Worse, it will attract the Australian Taxation Office Part IVA anti tax avoidance principles.

It has long been found in tax law that converting an individually held business into a company structure, if done to obtain a tax benefit, can be overturned or ignored by the Tax Commissioner. This principle has existed for a long time but was most clearly expressed in the 1985 High Court decisions of Gulland, Watson & Pincus. Unless there is another more dominant reason, the claimed tax benefits will not arise.

A good reason will exist where the AFSL imposes the corporate structure, such as happened in the early 1990's in the building industry. And there are many reasons why the AFSL may impose a need for a corporate structure.

But before embracing the tax refund, consider the impact of the Tax Act changes from 2000 that created the alienation of personal services income tests. We still do not know how effective these will be within the financial services industry; however, we suspect that these will not be as effective as the Tax Office would like.

If the decision for change is embraced and the corporate structure will be adopted, will it be costly and effective or will it be cheap and ineffective and probably fail when first tested?

One thing is certain; the Tax Office will know that there has been a change in the business. How? Your new tax return will be different to your old. It is fairly obvious that your business has altered.

So what are the costs? Apart from the usual such as changes in stationery, signage and marketing, the most relevant costs will be capital gains tax and stamp duty.

The first should be relatively easy to control. The Financial Planning Association induced changes to the taxation law brought about new division 124-0 of the Tax Act. This Division is specifically designed to grant rollover capital gains tax relief for FSR induced changes, but only if completed before 10 March 2004. If you are a day late, no rollover relief applies!

If you are a day late, don't panic, all the other usual capital gains tax rollovers will remain. This is important, you need not hurry to change, although the existence of FSR and 11 March does provide a good excuse, er, I mean opportunity.

The other major cost to any business reorganisation, the one that is most often ignored, is stamp duty. But it is ignored at great risk, the failure to pay stamp duty on a reorganisation can lead to a failure of the whole procedure at the time that you need it, in a Tax Office audit.

Stamp duty is not cheap, especially when it is not expected. The progressive nature of the tax is what hurts most. In NSW the stamp duty on two transfers of $500,000 is $17,990.00 each, however, the stamp duty on a single transfer of $1 million is $40,490.00. That is an extra $4,510.00 for the same value just because the tax is progressive.

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It is seen as an unjust tax because in any reorganisation there is no change in the beneficial ownership and yet the stamp duty is payable. There is no rollover relief as with capital gains tax.

Stamp duty is most often ignored because i*t is almost impossible to be stung for it; no one does any audits, so why bother paying it?*

State Revenue authorities are not lackadaisical, it is true they may not have the audit resources of the Federal tax authorities but they have their watchdog systems. Periodically they review the creation of new companies and enquire of the purchaser as to whether it was associated with a stamp dutiable transaction. If the restructured business requires any State registration, you yourself will put the State Government, and therefore the stamp duty authorities, on notice.

However, the most important reason of all to pay the stamp duty is the support it gives to the whole restructure, something that the Federal Taxation Office has become interested in from time to time. If it helps to prove an argument the Federal tax authorities will use the lack of stamping as a weapon to undermine the claimed tax objectives.

Whilst it is a State taxing law, the basic principles are nevertheless common. Section 304 of the NSW Duties Act, 1987 serves to demonstrate the issue; "*An instrument that effects a dutiable transaction or is chargeable with duty under this Act is not available for use in law or equity for any purpose… unless it is duly stamped"*.

There was a time when it was thought that what this meant was that the unstamped document could not be argued in Court. However, a range of cases that date back to the 1919 High Court decision of *Dent v More* have confirmed that what it means is that an unstamped document is not available in law or in equity; it is a legal nothing. The paper, upon which any reorganisation has been effected, is as though it is blank.

Sound too weird to be true? Of course it does, but this can't be the first time that you would have seen the law deem something for one purpose to be something else for other purposes. The whole of the financial services industry exists because Governments have deemed rules.

Are these the last days? If you want them to be, they can, but you had better have a good excuse if the objective is to change your tax position. And when you are doing it, pay the stamp duty, otherwise the Tax Office can argue that whatever you tried to achieve did not happen.

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