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Update Summary

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UPDATE 257 **NOVEMBER 2024**

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Material Code 42608636
Print Post Approved PP255003/00395

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Currency for CRA Update 5 of 2024

Author Dr James O'Donovan has added new commentary to the work addressing taxation implications of corporate restructuring. This material sits in **Appendix 7** behind **Reference Material – Schemes of Arrangement**. Matters of particular importance include the following.

Taxation implications of corporate restructuring

Bad debts

Bad debts that have previously been declared by the taxpayer as assessable income are deductible under s 25.35 of the *Income Tax Assessment Act 1997* (Cth). Such a deduction is only allowable in the year in which the debt is physically written off. Where the requirements of s 25.35 are not satisfied, a write-off for bad debts of business taxpayers may be allowed under s 8.1 of the *Income Tax Assessment Act 1997* (Cth). See [APX.7.10].

Debt- for- equity swaps

Generally, a debt-to-equity swap is tax neutral because the tax book value of the shares received equals the tax book value of the converted debt. However, a debtor that issues new shares to a creditor as part of a debt-to-equity swap may suffer a reduction of its tax losses. Moreover, the issue of new shares to a creditor outside the debtor's group may prevent the debtor from carrying forward tax losses because it might fail to satisfy the continuity of ownership test. See [APX 7.20].

The commercial debt forgiveness regime

Division 245 of the *Income Tax Assessment Act 1997* (Cth) creates a commercial debt forgiveness regime to ensure there are appropriate taxation outcomes when a commercial debt is forgiven. See [APX 7.40] – [APX 7.160].

Capital gains tax

After stating what constitutes a CGT asset, the author goes on to explain that under s 104.25(1) of the *Income Tax Assessment Act 1997* (Cth), a CGT event C2 occurs if a company's ownership of an intangible CGT asset ends by the asset being released, discharged or satisfied. Subsequently the following matters are addressed:

- Share buy-backs and capital gains tax – see [APX 7.200]
- Company buying back shares – see [APX 7.220]
- On-market share buy-backs – see [APX 7.240]
- Off-market share buy-backs in listed public companies – see [APX 7.260]
- Share buy-backs by companies that are not listed public companies – see [APX 7.280]
- Share buy-backs in private companies – see [APX 7.300]
- *Roll-over relief* – see [APX 7.320]

Company group restructuring

Subdivision 126-B of the *Income Tax Assessment Act 1997* (Cth) provides roll-over relief when an asset is transferred or created within a wholly-owned group of companies. However, given the constraints upon roll-over relief under these provisions, the subdivision has had little application since the consolidation regime was introduced on 1 July 2023. See [APX 7.380].

Consolidated groups

The author notes that Div 615 of the *Income Tax Assessment Act 1997* (Cth) permits a company to be interposed between exchanging members and the head company of a consolidated group both in disposal and redemption cases. The advantage of Div 615 roll-over relief is that it provides for the restructuring of a group by inserting a holding company without having to rely on either the roll-over relief in *Subdiv 122-A of the Income Tax Assessment Act 1997 (Cth) or Subdiv 126-B of the Income Tax Assessment Act 1997 (Cth)*. See [APX7.400].

Small business roll-over concessions

From 1 July 2016, small business restructure roll-over relief was provided where there has been no change in the "ultimate economic ownership" of an asset through a "genuine restructure". This allows eligible small businesses to defer all, or part of a capital gain made from selling an active asset. See [APX 7.420].

CGT Relief for Demergers

Since 1 July 2002, tax relief has been available for the restructuring of corporate groups by splitting them into two or more entities or groups. See [APX 7.440].

The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)

[APX 10.500] Objectives of the Second Tranche of AML/CTF Reforms

The Australian Government proposes to expand the AML/CTF regime to professional service providers (PSPs) who represent a high risk for money laundering exploitation, including insolvency practitioners, whether they are accountants or lawyers. It will do this by adding certain high-risk services provided by PSPs to the list of designated services under the Act. These reforms are referred to as the Tranche 2 reforms.

The purpose of the Tranche 2 reforms is to:

(a) raise awareness of the risks of money laundering and terrorist financing among professional service providers;

(b) provide professional service providers with the tools to prevent the misuse of their legitimate services by criminals;

(c) assist PSPs to identify early indicators of suspicious transactions and criminality, thereby reducing their exposure to criminal activity and reputational damage;

(d) to protect the integrity of Australia's financial system and the reputation of its economy. See [APX 10.500].

The author has also addressed the following issues:

- The key obligations – see [APX 10.540]
- Legal professional privilege – see [APX 10.560]
- Confidential information – see [APX 10.580]
- When will the Tranche 2 reforms come into effect? – see [APX 10.600]
- The sequence of the reforms – see [APX 10.620]
- The New Zealand experience – see [APX 10.640]

CRA Online update 4 of 2024 and Print update 258

In this update author Dr James O'Donovan completes the issuing of new material addressing corporate restructuring. The following chapters have been inserted: Chs 64 – 70. A brief overview of the contents of each chapter follows.

Chapter 64 – Share buy-backs

A share buy-back is a form of reduction of share capital in which the company pays its members for their shares but receives nothing in return because the shares purchased by the company must be cancelled or held in a treasury account but not traded. See [64.20].

The *Corporations Act 2001*(Cth) prohibits a company purchasing, or otherwise acquiring an interest in, its own shares except via permitted buy-backs or other mechanisms relating to self-acquisition and control of shares. See [64.80].

The author then addresses:

- Prescribed procedure for share buy-backs – see [64.160];

- Acceptance of the offer – see [64.180]; and
- Procedure for selective buy-backs – see [64.200].

Chapter 65 – Variation of class rights

The statutory requirements for a variation of class rights depend upon whether the company has a constitution prescribing the procedure for varying or cancelling class rights.

If a company has a constitution that sets out the procedure for varying or cancelling rights attached to shares in a class of shares, those rights may be varied or cancelled only in accordance with that procedure. The procedure may be changed only if the procedure itself is complied with.

If the company does not have a constitution, or has a constitution that does not set out the procedure for varying or cancelling rights attached to shares in a class of shares, then those rights may be varied or cancelled only by special resolution of the company *and* by special resolution passed at a meeting of the class members holding shares in the class *or* by the written consent of members with at least 75% of the votes in the class. See [65.60] – [65.100].

Commentary also addresses among other related topics:

- ASX Listing Rules – see [65.280];
- Applications to set aside a variation, cancellation or modification – see [65.320]; and
- Lodgement of documents and resolutions with ASIC – see [65.400].

Chapter 66 – Financial assistance to buy shares

There is a general prohibition in Corps Act 2001, s 260A preventing companies from providing financial assistance in the purchase of shares in the company. See [66.20] – [66.40].

The commentary addresses:

- What constitutes "material prejudice" for the purpose of the exceptions – see [66.100];
- Financial assistance approved by the shareholders – see [66.120];
- Exemptions under s 260A – see [66.140]; and
- Financial assistance in relation to schemes of arrangement – see [66.200].

Chapter 67 – Protection of employee entitlements

Companies operating in a group often choose to have only one company in the group employ the group's workforce for several legitimate reasons. However, problems arise where the companies in the group do not execute a deed of cross guarantee. In this situation the employees of the insolvent member of the group may lose their employee entitlements, with no redress against other companies in the group. The problem is

compounded where the employer company provides employee services to other companies in the group but does not charge arm's length rates for these services. See [67.20].

The legislative response is a three-pronged one to the misuse of corporate restructuring to the prejudice of employee entitlements and is helpfully summarised at [67.500].

Chapter 68 – effects of schemes of arrangement

The Australian Government has introduced a stay on the enforcement of ipso facto termination clauses in contracts and a general prohibition on the automatic termination of contracts under self-executing provisions. Specifically, since 1 July 2018 the "ipso facto" regime provides a stay of enforcement provisions in contracts entered into, where a scheme of arrangement is proposed for the purpose of avoiding an insolvent winding up. See [68.20] – [68.40].

Commentary addresses:

- the nature of the stay – [68.60] – [68.220];
- impact of the stay on creditors and third parties – [68.280] – [68.380]; and
- impact of the stay on proceedings, deeds of company arrangement, owners and on the scheme fund – [68.420] – [68.500].

Chapter 69 – Scheme managers

Obviously, scheme managers are central to the operation of the scheme. Persons other than registered liquidators require leave to be appointed as scheme managers. Such leave will be granted where it is desirable to appoint a suitably qualified person with experience of a specialised kind to administer a scheme of arrangement. See [69.20].

Scheme managers have the same fiduciary duties as a de jure director. Within 14 days after being appointed to administer a compromise or arrangement approved under Corps Act 2001, Pt 5.1, the scheme manager must lodge a notice in writing of the appointment. They have the same duties to lodge accounts as a receiver and manager. As officers of the company, scheme managers have statutory duties of care and diligence under Corps Act 2001, s 180 and good faith under s 181 and they must not use their positions or information coming to them in their positions to gain advantages for themselves or others or to cause detriment to the company. See [69.40] – [69.80].

Receivers can apply to the court for directions in relation to any matter arising in connection with the performance or exercise of any of their functions and powers. See [69.100].

The court's power to conduct an inquiry and make orders in relation to voluntary administrations has been extended to schemes of arrangement. See [69.120].

An appeal to the court lies from a decision by the chairperson to admit or reject a proof of debt or claim for voting purposes within 10 business days after the decision. See [69.140].

The court has power to fix the remuneration of scheme managers under, s 425. The scheme itself may contain provisions dealing with their remuneration. See [69.180].

Finally, there is no reason why scheme managers should enjoy any greater immunity than liquidators. Hence, the court will not approve a scheme of arrangement containing an exemption or indemnity clause in favour of the scheme manager, even if the creditors agree. See [69.200].

Chapter 70 – Termination of schemes of arrangement

When a scheme of arrangement is not carried into effect the scheme creditors revert to their original rights and claims. See [70.20].

The court has no statutory power to terminate a scheme of arrangement. The power to terminate a scheme lies in the terms of the scheme itself. See [70.40].