BRIEFINGS

WATERHOUSE CHARTERED ACCOUNTANTS

EDITION #42 September/October 2017

ASIC Targets Growing Companies In Audit Crackdown

ASIC is in the midst of a concerted campaign targeting private companies that have outgrown the reporting exemptions.

ASIC requires companies to prepare and lodge a financial report and a directors' report each financial year, and have the accounts audited unless the company is exempt. Most small companies are exempt from the compliance requirements as are small foreign owned companies in certain circumstances.

Utilising data from the Australian Taxation Office (ATO), ASIC is contacting companies that have moved beyond or not complied with the exemption and are now in breach of their reporting requirements.

If your company has never had to lodge financial reports with ASIC in the past, it's very easy to breach the rules without realising it. The reporting requirements are hard and fast and ASIC is not overly sympathetic to "oops" as a reason for a breach.

What is a small company?
Small companies are exempt if they satisfy at least two of the following:

- The consolidated gross revenue for the financial year for the company and any entities the company controls is less than $25 million
- The value of consolidated gross assets at the end of the financial year of the company and any entities it controls is less than $12.5 million, and
- The company and any entities it controls have fewer than 50 employees (full time equivalent) at the end of the financial year.

No longer a small company? Then you are a large company and are required to lodge audited financial statements.

Will the auditor want to audit the previous year's figures when we were still a small company? Yes.

This exemption is for companies not controlled by a foreign entity or disclosing entities.

Failure to lodge annual accounts with ASIC may result in penalties and potentially the company being deregistered.

The rules for foreign controlled companies
Small companies controlled by a foreign company may also be exempt in some circumstances.

For small companies that are not part of a large consolidated group, the directors must resolve to rely on relief provided by ASIC and lodge this resolution (form 384). Timing is everything to be eligible for this exemption, if the right form is not lodged between the period starting 3 months prior to the start of the financial year relief is first applied and ending 4 months after the end of the relevant financial year, the exemption is unlikely to apply.

ASIC warns that, "in most cases, relief is not granted for financial reports that were due in the past".

Foreign companies that fail to lodge the appropriate financials and are not exempt may be deregistered.

Again, if you have a requirement to lodge financial statements with ASIC, they must be audited.

If you are uncertain about the requirements for your company, please contact us and we'll work with you to ensure your company is compliant.

Super Guarantee – What Happens When You Get It Wrong

The ATO receives around 20,000 reports each year from people who believe their employer has either not paid or underpaid compulsory superannuation guarantee (SG). In 2015-16 the ATO investigated 21,000 cases raising $670 million in SG and penalties.

The ATO's own risk assessments suggest that between 11% and 20% of employers could be non-compliant with their SG obligations and that non-compliance is "endemic, especially in small businesses and industries where a large number of cash transactions and contracting arrangements occur."

Celebrity chefs are the latest in a line of employers to publicly fall foul of the rules - one for allegedly inventing details on employee payslips and another for miscalculating wages. But what happens if your business gets SG compliance wrong?

Under the superannuation guarantee legislation, every Australian employer has an obligation to pay 9.5% Superannuation Guarantee Levy for their employees unless the employee falls within a specific exemption. SG is calculated on Ordinary Times Earnings – which is salary and wages including things like commissions, shift loadings and allowances, but not overtime payments.

Employers that fail to make their superannuation guarantee payments **on time** need to pay the SG charge (SGC) and lodge a Superannuation Guarantee Statement. The SGC applies even if you pay the outstanding SG soon after the deadline.

The SGC is particularly painful for employers because it is comprised of:

- The employee's superannuation guarantee shortfall amount – so, all of the superannuation guarantee owing
- Interest of 10% per annum, and
- An administration fee of $20 for each employee with a shortfall per quarter.

Unlike normal superannuation guarantee contributions, SGC amounts are not deductible, even if you pay the outstanding amount. That is, if you pay SG late, you can no longer deduct the SG amount even if you bring the payment up to date.

And, the calculation for SGC is different to how you calculate SG. The SGC is calculated using the employee's salary or wages rather than their ordinary time earnings. An employee's salary and wages may be higher than their ordinary time earnings particularly if you have workers who are paid for overtime.

Under the quarterly superannuation guarantee, the interest component will be calculated on an employer's quarterly shortfall amount from the first day of the relevant quarter to the date when the superannuation guarantee charge would be payable.

The penalties imposed on the employer for failing to meet SG obligations on time might seem harsh, but they have been designed that way on purpose. This is really money that belongs to the employee and should be sitting in their superannuation fund earning further income to support the employee in their retirement.

Directors are personally liable for unpaid SG
Where attempts have failed to recover superannuation guarantee from the employer, the directors of a company automatically become personally liable for a penalty equal to the unpaid amount.

Directors who receive penalty notices need to take action to deal with this – speaking with a legal adviser or accountant is a good starting point.

If you are uncertain about your SG obligations or would like a compliance audit of this and other key risk areas of your business, give us a call.

Director's fees: What and How to Pay Them

The issue of Director's fees often comes up – should we pay directors, how to pay, and if we do pay fees how should they be paid? We answer the common questions for private companies.

Can you pay a Director?
Directors who work in the company, executive directors, would generally have an agreed executive remuneration structure that takes into account their service including attending Board

meetings (so, generally no extra fees for service outside of the agreed remuneration structure).

For non-executive directors, companies can only pay Director's fees if the company constitution allows for it or a resolution is passed to make the payments. The resolution to pay directors fees must be made and documented prior to the fees being paid.

These fees are in addition to any agreed expenses such as travel expenses to attend board meetings or in connection with the company's business.

Fees paid to directors are subject to disclosure requirements. Special rules exist for listed entities, not for profits, APRA-regulated financial institutions and specific advice should be sought for the management of director fees by these entities.

Tax deductibility of director's fees
Fees paid to Board members are tax deductible to the company in the year they are paid or intended to be paid. Many Boards pass a resolution to pay Director's fees just prior to the end of the financial year to claim the tax deduction in that same year. The fees do not necessarily have to be paid prior to the end of the financial year but the Board must have definitely committed to paying them and then the fees paid as soon as practicable.

Tax on director's fees
Assuming the directors fees are being paid through an individual contractual arrangement (i.e. the contract is with Mr Smith to act as a director, not with Smith Pty Ltd to provide 'someone' as a director, and that happens to be Mr Smith), then the directors fees are treated like salary and wages for the purposes of PAYG withholding. PAYG is required to be withheld from the gross directors fees, reported on the IAS or BAS that is used to report the salary and wages and related PAYG W for that period, and should be remitted to the ATO.

Director's fees fall within the definition of Ordinary Times Earnings, and superannuation guarantee applies.

Director fees are required to be reported on a payment summary, and are generally reported at item 2 of an individual's tax return. If they are not reported on payment summaries, it could result in errors in the PAYG withholding annual report, and queries from the ATO regarding the payments.

While the ATO may recognise that there can be a difference in the provision of services by and payments to directors (e.g. the contract may be for ongoing director services and attendance at quarterly board meetings, with payments of director fees to be made once a quarter, not monthly), the PAYG W and superannuation contributions are still subject to reporting and payment by the standard deadlines that apply for all other employees.

The directors fee should also be included in any workers compensation calculation and would generally be captured for payroll tax purposes as well.

Can Director's fees be paid as super contributions?
Yes, assuming the proper process has been followed (e.g., effective salary sacrifice arrangement has been entered into before the fees have been earned), fees can be paid to the Director's superannuation fund as a reportable employer contribution to utilise preferential tax rates. This assumes the director is within their contribution limits.

New Laws hold franchisors responsible for vulnerable workers

Franchisors and holding companies could be held responsible if their franchisees or subsidiaries don't follow workplace laws.

The Government has stepped in to protect workers following months of controversial headlines uncovering poor record keeping, questionable workplace practices and exploitation, underpayments, deception, and superannuation guarantee fraud by employers.

The *Protecting Vulnerable Workers Bill* amends the Fair Work Act to:

Increase penalties for 'serious contraventions' of workplace laws
A 'serious contravention' of workplace laws occur if someone knowingly contravenes the law and their conduct is part of a systematic pattern. The penalties for breaches vary according to the offence and have increased up to 10 times higher than cases without the aggravating features. A breach is more likely to be a 'serious contravention' if:

- there are concurrent contraventions of the Fair Work Act occurring at the same time (e.g., breaches of multiple award terms and record-keeping failures);
- the contraventions have occurred over a prolonged period of time (e.g., over multiple pay periods) or after complaints were first raised;
- multiple employees are affected (e.g., all or most employees doing the same kind of work at the workplace, or a group of vulnerable employees at the workplace); and
- accurate employee records have not been kept, and pay slips have not been issued, making alleged underpayments difficult to establish.

Prevent record keeping failures
Appropriate record keeping is a big part of the new laws to prevent poor employer practices being used as a defence; stymieing employee complaints for lack of evidence. Now, the onus of proof is on the employer to disprove an employee's compliant.

The penalties for poor record keeping have also increased dramatically - now up to $12,600 for a standard breach and $126,000 for 'serious contraventions' by individuals and $630,000 for corporations. Maximum penalties are likely to apply where the employer knowingly falsified records and provided false or misleading payslips.

Hold franchisor entities and holding companies liable
New provisions hold franchisors and holding companies responsible for certain contraventions of the Fair Work Act by businesses in their networks.

The Government is concerned that some franchisors have either been blind to the problem of underpayments to workers or have not taken sufficient action to deal with it once it was brought to their attention.

The provisions only apply to responsible franchisors that have a significant degree of influence or control over the relevant franchisee's affairs. Holding companies are assumed to have control. This means that franchisors and holding companies are held responsible "if they knew or could reasonably be expected to have known that the contraventions would occur, or that contraventions of the same or a similar character were likely to occur and they had significant influence or control over the companies in their network."

Where franchisors (or their officers) recognise a problem and take action quickly to resolve it, it is unlikely that they will be held liable. This means that affected companies will need to have appropriate systems and monitoring in place to ensure that franchisee's are acting within the law. This might include ensuring that franchise agreements or other business arrangements require franchisees to comply with workplace laws, establishing a hotline or contact point for employees, and auditing the businesses in the network.

Ban 'cashback' from employees or prospective employees
Workers in the 7-Eleven case reported that they were paid correctly but then required to hand cash back to the franchisee or lose their job. The Fair Work investigation found that this practice "was not isolated and was prevalent in a number of 7-Eleven stores."

Asking an employee for 'cashback' so the person can keep their job, or to keep wages below minimum entitlements will always be unreasonable and prohibited. Penalties have increased tenfold for cases where these aggravated circumstances apply.

Powers and penalties of the Fair Work Ombudsman ramped up
During the 7-Eleven investigation, the Fair Work Ombudsman (FWO) expressed frustration at their limited investigative powers. The new laws provide the FWO with similar powers to the Australian Securities and Investment Commission and the Australian Competition and Consumer Commission. The new powers not only bolster information gathering but also provide the FWO with an enforceable power of questioning for the first time.

The FWO can now issue an 'FWO notice' requiring someone to give information, produce documents, or attend before the FWO to answer questions.

New penalties also apply for giving false or misleading information, or hindering or obstructing a Fair Work investigation.

The maximum penalty for failing to comply with an FWO notice is $126,000 for individuals and $630,000 for corporations.

Alert: What you need to tell the ATO about your SMSF

The 1 July 2017 superannuation reforms introduced a new reporting regime for funds. Funds now need to advise the ATO of key events within the fund that impact on retirement income streams (pensions):

- When you start a pension
- When you stop a pension or take a lump sum
- When the fund accepts a structured settlement contribution such as personal injury compensation.

Superannuation funds are also required to report the value of existing superannuation income streams at 30 June 2017.

While reporting of these events to the ATO does not formally start until 1 July 2018 for SMSFs, event based reporting still needs to be completed if these events occur from 1 July 2017 – that is, you have a reprieve from the compliance but not the actual reporting.

If we are managing your SMSF's accounting and compliance, we will track most of these events for you electronically where you have enabled us to access feeds from your SMSF's bank accounts. If we see any transactions that could meet the reporting criteria, we will be in touch with you to confirm the nature of these events.

Where electronic feeds are not available - if your bank does not support them or where you have opted not to enable the feeds, you will need to let us know about these events at the time they occur.

In addition to the new events based reporting regime, SMSFs are also obliged to report any of the following changes to the ATO within 28 days.

- Fund name
- Fund address
- contact person for the fund
- fund membership
- fund trustees, and
- the directors of the fund's corporate trustee

Safe harbour for directors of struggling companies

Australia's insolvent trading laws impose harsh penalties on directors of companies that trade where there are reasonable grounds to suspect that the company is insolvent. Criminal and civil penalties can apply personally including penalties of up to $200,000, compensation proceedings by creditors or liquidators, and where dishonesty has been involved, up to 5 years in prison.

You can understand why directors might choose to place a company into administration rather than face personal risk. Section 588G(2) of the Corporations Act imposes personal liabilities if a person is a director at the time the company incurs a debt, and the company is insolvent or becomes insolvent by incurring that debt, and, at that time, there are reasonable grounds to suspect that the company is or would become insolvent. It's all about timing.

The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment a company becomes insolvent have been widely criticised as driving directors towards voluntary administration even in circumstances where the company may be viable in the longer term. And, the very real personal risk is often cited as a reason why experienced directors are unwilling to engage with angel investors and start-ups.

New safe harbour provisions give directors some 'wiggle room' where they are attempting to restructure a company outside of a formal insolvency process.

Under the new rules, directors will only be liable for debts incurred while the company was insolvent if they were not developing or taking a course of action that at the time was reasonably likely to lead to a better outcome for the company than proceeding to immediate administration or liquidation. The explanatory memorandum to the amending legislation however clearly states that "hope is not a strategy" when it comes to assessing the reasonableness of the actions taken by directors.

Tolerance levels of the new laws

The new laws give directors a safe harbour from the civil insolvent trading provisions of the Corporations Act but only where the company is up to date with employee entitlements including superannuation, and has met its tax obligations – normally the first thing to go in distressed companies.

The amendments create a safe harbour for "honest and diligent company directors from personal liability for insolvent trading if they are pursuing a restructure outside formal insolvency." Directors who merely take a passive approach or allow the company to continue trading as usual during severe financial difficulty, or whose recovery plans are "fanciful", will not be protected. Directors who fail to implement a course of action, or to appoint an administrator or liquidator within a reasonable time period of identifying severe financial difficulty will also lose the benefit of the safe harbour.

What does all this mean?
The new rules do not soften the requirement for directors to stay informed about the welfare of the company. It merely provides protection where there is a reasonable chance of a turnaround from insolvency. To utilise the safe harbour, directors will need to demonstrate that they took action that "could lead to a better outcome" such as:

- **Accessing the right information to make timely and informed decisions** – engage professional advice to assess the company's solvency and provide the right information at meaningful time periods. As soon as the company's solvency is questionable, steps should be taken to ensure further debts are not incurred. The result of this assessment might be that the company is not able to reasonably turnaround its financial position.
- **Assess if the safe harbour could apply** - A decision to utilise the safe harbour provisions should be taken at Board level. Professional advice should be taken to review eligibility and viability of accessing the safe harbour provisions.
- **Develop a plan** – document a plan with measureable and realistic targets. You need to demonstrate that the plan is "reasonably likely to lead to a better outcome" for the company. Any contracts the company has entered into also need to be reviewed as part of that plan.
- **Measure and adjust** – The plan should not only be followed but also regularly assessed and amended where required for changing circumstances. Directors have an obligation to understand the point at which the plan is not working and to work co-operatively with liquidators or administrators. The safe harbour does not protect directors who do not keep tight controls on the viability of a turnaround plan. Keep informed and realistically assess the company's position.

Can the company incur debt while insolvent?
The safe harbour provides protection for debts "incurred directly or indirectly in connection with" actions taken to turnaround the company. It includes debts taken on for the specific purpose of the restructure such as a professional adviser. Even in circumstances where a company's solvency is doubtful, incurring debts may be a reasonable course of action to lead to a better outcome, and it may remain in the interests of the company that some loss-making trade should be accepted - for example, incurring debts associated with the sale of assets which would help the business's overall financial position.

While hindsight might demonstrate that the path taken was the wrong one, directors are protected if they can demonstrate that the course of action was reasonably likely to lead to a better outcome at the time the decision was made. The safe harbour does not protect from debts incurred outside of the turnaround actions.

Solvency is an issue that arises for companies of all sizes; particularly those on a fast growth trajectory. It's essential that directors have the right information available to them to manage these periods of uncertainty. Employee and tax payments, and tax reporting should never be missed as these are the first sign of deeper problems and likely to trigger further investigation or audit by the regulators. If the company needs help, get help. Hope is not a strategy.

Tax benefits for investing in affordable housing

In the 2017-18 Federal Budget the Government announced a series of measures intended to improve housing affordability in Australia. To entice investors, the Government is providing an increase in the CGT discount for individuals who choose to invest in affordable housing.

The draft legislation enabling this change has now been released so we can see the detail.
There are two aspects to these changes. Firstly, individuals who make a capital gain on residential dwellings that have been used to provide affordable housing can potentially qualify for an additional CGT discount of up to 10%, this could take the total discount percentage from the existing maximum level of 50% to 60%. While the additional 10% CGT discount applies if you meet

the eligibility criteria, the 60% discount rate is not automatic – it's 'up to' and the final total discount could be less than 60%.

The increased discount will only be available if the dwelling has been used to provide affordable housing for at least 3 years after 1 January 2018. The 3 year period does need to have been continuous.

The additional discount needs to be apportioned to take into account periods when the individual was a non-resident or temporary resident as well as periods when the property was not used to provide affordable housing over its ownership period.

The second aspect to the rules allows individuals to also access an additional 10% CGT discount on their share of capital gains that are distributed by a certain trusts (e.g., managed investment trusts) where the gain is attributable to dwellings that have been used to provide affordable housing for at least 3 years.

Affordable housing is….
There are a few compliance hoops to jump through to be 'affordable housing'.

- The property must be residential (not commercial)
- the tenancy of the dwelling or its occupancy is exclusively managed by an eligible community housing provider;
- the eligible community housing provider has given each entity that holds an ownership interest in the dwelling certification that the dwelling was used to provide affordable housing;
- no entity that has an ownership interest in the dwelling is entitled to receive a National Rental Affordability Scheme (NRAS) incentive for the NRAS year; and
- if the ownership interest in the dwelling is owned by a Managed Investment Trust, the tenant does not have an interest in the MIT.

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained

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