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F.S.T. e-bulletin

Financial Services e-bulletin

Retirement Villages – Is your village an illegal managed investment scheme?

Public taxation ruling **TR 94/24** gave rise to various taxation schemes in the form of partnerships to develop retirement villages. The schemes generally were structured using loan arrangements that allowed a deduction in excess of the cash contributions by the partners.

Unfortunately many of the promoters did not consider, or if they did consider then totally ignored the question of whether their partnership or other association of persons was a managed investment scheme which required registration. As has been seen in many cases, the definition of “managed investment scheme” is very wide and appears to be a “catch all” for investment arrangements that are not securities. For example, in a recent case, an arrangement involving a fundraising through promissory notes was held not to be a security but was held to be a managed investment scheme.

ASIC has taken action in relation to some of these schemes to have them wound up. Winding up generally is not in the interests of the investors and sometimes is in the interest of the very person who promoted the scheme if they are the underlying land owner.

It is important that promoters of investments in retirement village developments consider whether they are required to register the scheme and/or whether they require an Australian financial services licence in relation to the conduct of their promotional activities.

If you are operating an illegal scheme then some consideration should be given to rectifying the problem such as transferring assets to a legal scheme using the winding up power.

Retirement Village Exception in definition of managed investment scheme – Why does this not apply to the investing scheme?

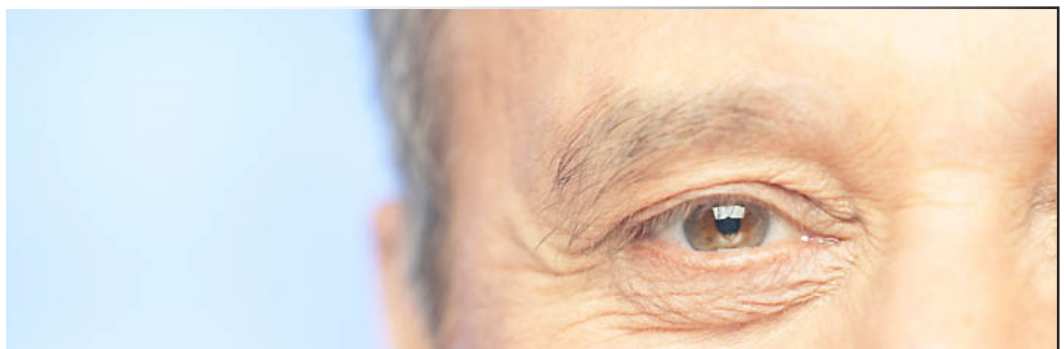
The definition of managed investment scheme has an exception for a retirement village scheme. However, this does not apply to a scheme which owns a retirement village such as a property trust. It only relates to the retirement village itself which otherwise would fall within the definition. This is because the relevant scheme for the exception is the retirement village itself and not the scheme which owns the village. This view is supported by ASIC action in relation to the ownership of retirement villages where the schemes that owned the villages were subject to winding up orders by reason of the operation of an illegal scheme.

Retirement Villages – Current tax treatment

The reason for the former **TR 94/24** was to overcome a mismatch in the income tax system between deductibility of expenditure and assessability of income. The ruling effectively allowed a deduction for the cost of development against the receipts for the sale of the retirement units. Therefore, a developer of a retirement village was assured that it would obtain a deduction from the gross receipts from the sale of the right to occupy those units for the expenditure in developing the unit. Even though this may not have been the correct interpretation of the law, nevertheless it ensured a proper matching of deductions with receipts.

However, care now needs to be taken by developers to avoid a mismatch between revenue and deductions. The Commissioner now operates under a new ruling **TR 2002/14**.

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Where a village operator develops or acquires a retirement village to conduct the business of granting occupancy rights to village residents, the costs of acquiring or developing the village is expenditure of a capital nature. On the other hand, if the form of arrangement with the occupant is not correctly structured, the whole of the receipt on the grant of the occupancy right may be a receipt on revenue account and be taxable without offset of the expenditure which is now on capital account. The old lease premium arrangements therefore will no longer work. Even the lease/loan arrangements need careful consideration to ensure there is no mismatch between deduction and income on revenue account.

Retirement Villages – GST

GST is a complex issue for retirement villages. The supplies may be taxable, input taxed or GST free. It is important to distinguish the nature of the supply. For example, the supply may be taxable on the first supply of the unit as new residential but input taxed on the next supply. On the other hand some supplies of a unit are GST free, such as if the premises are supplied to a resident who requires daily living activities assistance or nursing services and the premises are supplied in connection with the supply of care services and other services such as meals, etc that meet certain requirements. The nature of the supply is important not only for ensuring proper pricing

of the service but also with respect to the entitlement to input tax credits.

Retirement Villages – Trading trust issue

When a property trust acquires a retirement village, consideration needs to be given as to whether it will become a trading trust by such acquisition. The consequences can be disastrous because a trading trust is essentially taxed as a company which means that the usual benefits of operating as a trust will be lost. It may be necessary to be structured so that the operator is a company with the trust leasing the property to that operator.

Authorised Representatives – disclosure of associated AFS licensee

ASIC has issued an information release (IR 06-35) on the disclosure obligations of authorised representatives to identify their AFS licensee in business documentation.

ASIC states that business cards and promotional material, which are likely to be seen without additional explanatory material, should make it clear that an authorised representative is acting as an authorised representative and not as principal. Such documents should clearly disclose the identity of the licensee for whom the authorised representative acts. This includes websites, brochures, flyers and advertisements of any kind.

The stated reason for this is to ensure that consumers are not left with the impression that the authorised representative is acting as principal when they are not. ASIC also states that this disclosure is also particularly important for consumers because it is the licensee who is ultimately responsible for the financial services provided by an authorised representative.



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Although this is only an information release, nevertheless good practice dictates that authorised representatives should comply with ASIC's views particularly since non-disclosure could in certain circumstances give rise to criminal and/or civil sanctions.

Proposed Further Financial Services Reforms

The Australian Government has issued a consultation paper on further reform proposals in the financial services area on which written submissions have been requested.

Some of the proposed areas of reform include the following amendments:

Managed Investment Schemes – Relief on prohibition on investment in foreign unregistered schemes

- > Section 601FC(4) of the Corporations Act will be amended to remove the prohibition on investments in unregistered schemes that are predominantly operated outside Australia and are not operated by the responsible entity itself, or any associate of the responsible entity.

Currently section 601FC(4) restricts the ability of managed investment schemes operating in Australia from investing in foreign trusts such as REITS. The proposed amendment will facilitate such foreign investments where the arrangement is effectively arm's length.

New in-use notice provisions

- > There will be a new on-line notification procedure which will provide for notification of changes.

At present there is a problem when a PDS is withdrawn or closed. There is no method of dealing with this at the present time. Hence an interim stop



order may be issued when the issue is closed. Defending such an interim order at that time is a waste of time and resources. However ASIC can then only deal with the matter by issuing a final stop order if the matter is not defended.

The new provisions will enable this problem to be dealt with. However there will be other matters which will need to be notified such as changes in the fee schedule.

Offers not requiring disclosure

- > There will be introduced into Chapter 7 of the Corporations Act (financial services regulation) a provision similar to section 708(10) in Chapter 6D.2 (disclosure provisions relating to securities as distinct from other financial products).

Section 708 contains provisions relating to offers which do not require disclosure. Many of these are repeated in Chapter 7.9 in relation to other financial

products. However one glaring omission from Chapter 7.9 is the exception in subsection (10) of section 708. Therefore there is a difference in the exceptions applying to securities and exceptions applying to other financial products.

This exception permits an offer without disclosure where the licensee is satisfied that the person to whom the offer is made has previous experience that allows them to knowledgeably assess the offer and that the licensee provides a written statement to the person of their reasons for being satisfied and the person to whom the offer is being made signs a written acknowledgement that they have not been provided disclosure in relation to the offer.

New rights issues exception

- > Rights issues for quoted securities and quoted financial products do not require the production of a prospectus or PDS.

However a cleansing notice modelled on the relevant provisions in section 708A of the Corporations Act must be provided before the rights issue offers are made, and that the notice must include appropriate information on the consequences of any potential effect of the rights issue on the control of the entity.

This is a good proposal. Where financial products are quoted there are detailed applicable continuing disclosure requirements and existing shareholders should therefore not require further disclosure of the same information in a prospectus. Subject to compliance with the above proposed provisions the costs of rights issues for quoted securities should be substantially reduced and also relieving companies from regulatory compliance burdens. It will also enable companies to issue shares to retail holders whereas at present because of the regulatory burden they are more likely to make share placements to institutions to the disadvantage of current holders.

Stapled Securities

- > A combined replacement Prospectus/PDS will now be permitted for stapled securities and interests.

Currently there is a problem because there is no provision for a replacement PDS. This means issuing a new combined Prospectus/PDS thus having a new exposure period. This problem with stapled securities/interests will now be dealt with.

Employee Share Schemes (ESSs)

- > The self-acquisition of shares by companies will not apply in the context of ESSs subject to certain safeguards.
- > ESSs will be exempted from the licensing, advertising and hawking provisions generally and not just listed companies which currently get relief under ASIC class order.
- > The exemptions in relation to an unlisted company ESS will however be subject to the requirement that the ESS is disclosed in an OIS or other disclosure document.

- > Contribution plans will be exempt from the requirement to be registered as a managed investment scheme, and issuers of interests under contribution plans are exempt from the need to hold an AFSL for dealing in an interest in a managed investment scheme.
- > The OIS threshold will under the proposed reforms be increased from \$5m to \$10m. However the amount raised in an ESS will not be included in this amount of \$10m.

Bringing Chapter 6D.2 into line with Chapter 7

There are different provisions applying to disclosure in relation to securities from other financial products. Some of these provisions are being brought into line under the proposed reforms. These include:

- > The relevant provisions included in the Corporations Amendment Regulations 2005 (No. 5) in relation to wholesale investors in Chapter 7 will be applied to the definition of sophisticated and professional investors in Chapter 6D to align the two provisions.
- > The prospectus advertising provisions relating to quoted securities and advertising post lodgement of a prospectus for unquoted securities are to be aligned with the provisions that apply to other financial products.

Sales recommendations not advice

- > Financial service providers may provide sales recommendations that are not considered to be financial advice in some situations.

This will avoid the confusion as to whether a financial service provider is selling product or providing financial advice – in many situations a product sale is disguised as financial advice and the present legislation contributes to this problem.

No FSG for some meetings

- > A Financial Services Guide will not need to be provided at a forum where 10 or more retail clients attend, whether or not it is open to any person to attend the forum.

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