

THE Financier

THE FINANCIERS ASSOCIATION OF AUSTRALIA LIMITED NEWSLETTER

www.financiersassociation.com.au

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Welcome to the Winter 2007 edition of The Financiers Association of Australia Limited newsletter. As usual we try to keep up with any legislative changes in the credit code as well as inserting any interesting general business pieces gleaned from various sources.

A welcome is also extended to new members at this time.

GST traps for mortgages

A mortgagee's loan to value ratio (LVR) can be instantly increased 10% by incorrect treatment of GST. In some circumstances the ATO effectively becomes a secured creditor ranking ahead of the mortgagee.

Fundamental to a mortgagee's credit assessment is the mortgagee's position as secured creditor. For example, if a mortgagee's credit policy requires loans not to exceed 80% LVR, it is fundamental to the transaction that the mortgagee ranks as first mortgagee for that amount. Normally, the ATO ranks after the mortgagee for collection of GST on the sale of the secured property. However, there are situations when the ATO effectively ranks **before** a mortgagee.

A lender lends 80% of an asset's value of \$100,000. Subsequently, the lender exercises power of sale for \$80,000, expecting to receive the whole of its principal back. However, the lender is obliged to pay 1/11th of \$80,000 as GST namely \$7,272. This reduces the lender's return by about 9%, which is a very significant loss for a

lender which felt it had adopted prudent lending practices.

While it is not strictly correct to say that the ATO ranks ahead of the secured creditor, the commercial effect is the same. The mortgagee or its representative becomes obliged to pay GST and so the mortgagee's recovery is reduced by the GST.

The actual amount of GST payable may be reduced if the margin scheme can be applied. Also, in some cases there may be no GST on the sale if the sale of the property is exempt from GST (for example, the sale of second hand residences or the sale of a going concern)

When does the ATO rank ahead of a secured creditor for GST?

The mortgagee or its representative is obliged to pay GST if the mortgagee is in control of the sale of the asset.

The mortgagee will be deemed to be in control if a sale is made in any of the following ways:

- mortgagee exercising power sale

- mortgagee using a power of attorney to sell the mortgagor's property
- mortgagee's receiver or receiver and manager sells.

Even where a mortgagee is not in control, representatives personally liable for GST will only sell in circumstances where the secured creditor has agreed to accept the proceeds after payment of GST. These include a liquidator or administrator of a company, and a trustee in bankruptcy for a bankrupt individual.

What is the position of a second mortgagee?

If a first mortgagee or a receiver appointed by the first mortgagee sells the property, the first mortgagee will be obliged to pay the GST to the ATO on the total sale price.

The second mortgagee only receives payment after the first mortgagee's debt is satisfied and the GST is paid.

Usually sale proceeds are to be applied in the following order:

- first, in payment of expenses of the sale
- second, to the mortgagee

- third, to any supplement mortgagees
- finally, any surplus to the mortgagor.

GST will form part of the expenses of the sale. This has been recently confirmed in the case of the *Health Pit II Pty Limited v Lowe* [2007] NSW SC67.

extract Gadsens Solicitors newsletter

NSW leads push to reign in credit card debt

News release NSW fair trading 18 May 2007

At a meeting of Fair Trading and Consumer Affairs Ministers from Australia and New Zealand today, NSW Fair Trading Minister, Linda Burney, will lead discussion on responsible lending practices for credit card providers.

Ms Burney said that this is one of a number of important consumer finance and credit issues she will be raising with the Ministerial Council on Consumer Affairs (MCCA), at their meeting in Melbourne.

"The ease of access to credit cards, the ready availability of increased credit limits, and lack of rigour applied by lenders to assess a person's ability to repay is leading to an ever-increasing number of people being caught in a cycle of debt."

"Reserve Bank figures for February 2007 show that Australians have an average outstanding balance of \$2,952, up 8.1% on the same time last year and there are over 13 million credit card accounts with

an average limit of \$7,719 which is up 4.7% on last year."

"Consumer advocates also report significant increases in the number of consumers seeking their help after getting in over their heads."

"I have heard about young people in casual employment or unemployed with massive credit card debts."

"It is astounding that most of these people have been given credit beyond their ability to repay and in many cases beyond what they had even sought."

"The majority of cases taken up by the NSW Consumer Credit Legal Centre, on behalf of people who identified credit debt as a problem, involved people living on Social Security payments, and many suffered from mental illness. They had debts ranging up to \$70,000."

"These debts can have far reaching impacts on people's lives and be a source of family disharmony."

Ms Burney said that the NSW Government is developing a regulatory impact statement with proposals aimed at improving practices for the approval and issuing of credit cards. It is anticipated it will be released for comment later this year.

"Another important step in protecting consumers in relation to personal credit and the subsequent debt this can bring is through tighter controls on the growing finance broking industry," Ms Burney said.

"States and territories have agreed that national regulation of finance

brokers, including a licensing regime, is needed."

"NSW has been leading discussion with industry and other stakeholders to make this happen and a draft consultation bill is expected to be available for public comment by mid 2007."

No-interest loans = no protection for consumer

News release qld fair trading May 2007

No-interest loans sound like a dream come true, but they may turn out to be a nightmare.

Fair Trading Minister Margaret Keech warns Queenslanders to be wary of 'no-interest loans' as a form of credit.

"With no-interest loans, the credit component is hidden in the purchase price," Mrs Keech said.

"This means your repayments are just as high as they would be if you were charged interest.

"But because there is no apparent charge for the loan, the Consumer Credit Code protections do not apply."

"I strongly recommend that consumers inform themselves about the true cost of any credit they sign up for and only take out loans covered under the Consumer Credit Code."

For more information on loans to be wary of, grab a copy of *How to Be Moneywise* at www.fairtrading.qld.gov.au or phone on 13 13 04.

Does borrowing to discharge a bankruptcy fall under the Consumer Credit Code?

First Mortgage Managed Investments Ltd v Oberlechner [2006] NSWSC 1397 (19 December 2006)

Alfred Oberlechner wrote software for the Commonwealth Bank. He bought a number of investment properties. When he was made redundant he became depressed and as a result, hasn't worked since 2000. His mortgage payments on the properties went unpaid. In August 2003, he was made bankrupt.

However, at the time of the bankruptcy, he was solvent. The total value of his realisable assets exceeded his liabilities. The value of his investment properties was greater than the money owed on the mortgages.

He tried to refinance. In May 2004, he borrowed \$615,000 from First Mortgage Managed Investments Ltd on the security of new mortgages of two of his properties. Oberlechner signed declarations that he had received independent legal advice before signing the documents. The documents included a declaration that the credit provider was providing the credit "wholly or predominantly for business or investment purposes (or for both purposes)".

The loans from First Mortgage and his other refinancing allowed him to discharge the bankruptcy. However, he still had no income so he soon defaulted on the loan repayments to First Mortgage.

On 21 September 2005 orders were made by the NSW Supreme Court, by consent (i.e. with the agreement of both Oberlechner and First Mortgage). This gave First Mortgage judgment for possession of 8 Elizabeth St., Tura Beach, and permission to issue a writ of possession. However, both the judgment and the writ were stayed for 19 days to give Oberlechner time to try to refinance. From that point, Oberlechner obtained various orders continuing and extending the stay. A stay was still in place as at December 2006, over 14 months later.

Oberlechner continued to try to fight First Mortgage's attempts to gain possession of the properties. One of his arguments was that the Consumer Credit Code applied. If this was so, the various requirements of the Code were unlikely to have been followed, given that First Mortgage believed they were dealing with a borrower for business or investment purposes.

The onus lies on the lender to show that the Code doesn't apply. The judge said that "ordinarily, the purpose of a loan provided to discharge a person's bankruptcy would be personal, domestic or household. Such a loan would relate to the status of the person ... , to the person's characteristics and to the circumstances of her or his domestic or household situation."

However, he said that here, the circumstances were exceptional because Oberlechner was actually solvent. His bankruptcy would have been discharged anyway if the trustee in bankruptcy had been permitted to sell his properties. He concluded that Oberlechner refinanced, not "wholly or predominantly" to discharge the bankruptcy, but to

ensure that he could keep the investment properties. He therefore concluded that the mortgage was not wholly or predominantly for personal, domestic or household purposes and that the Code did not apply. This meant that he didn't have to deal with the effect of the declarations of purpose made by Oberlechner.

Any and every stay preventing First Mortgage from proceeding was set aside from 8 January.

Sky high returns are just pie in the sky

Looking for some sky-high options for your money? Why not put your money into the Mercorella investment scheme, offering 36 per cent per year? You could even get up to 72 per cent if you sign up your friends and acquaintances.

Alternatively, you could split a cool \$35 million with a Dr Paul Mbizala who's got his hands on money belonging to investors in a US managed fund.

Once you've made your packet, you could fly out of Australia on a cheap flight overseas bought from New Flights Limited. Except the company is a fake, is not registered with ASIC, and buys the tickets with stolen credit cards.

These outrageous offers are all fakes that won't come true. That's why they're the top nominations for the ASIC 'Pie In The Sky' award for 2007.
