An insolvency practice specialising in effecting recoveries for creditors from insolvencies by identification and management of legal claims.

PARTNERS
John Sheahan FCA
Ian Lock BEng(Hons), FCA(ICAEW)
Paul Dugan LLB(Hons), GDLP

SENIOR ASSOCIATE
Nicholas Fryer BSc(Hons)

ASSOCIATE
Cameron Lockett BCom, LLB, GDLP



# SHEAHAN LOCK PARTNERS

Level 8, 26 Flinders Street
ADELAIDE SA 5000
Telephone: (08) 8231 0077
Facsimile: (08) 8231 0370

GPO Box 1173
ADELAIDE SA 5001

www.slp.net.au

Level 2, 32 Martin Place
SYDNEY NSW 2000
Telephone: (02) 9232 1222
Facsimile: (02) 9232 1299



Our ref: IL Admin/48131
Partner: Ian Lock
Direct email: ilock@slp.net.au
Direct telephone: 08 8110 0803

27 May 2004

By email: laca.reps@aph.gov.au,

The Secretary
House of Representatives Standing Committee on Legal and Constitutional Affairs
Parliament House
Canberra ACT 2600

Dear Sir/Madam,

**Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004**

I note that on 14 May 2004 the Attorney-General, the Hon Philip Ruddock MP, referred an exposure draft of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 together with an accompanying draft Explanatory Memorandum, to the House of Representatives Standing Committee on Legal and Constitutional Affairs for inquiry and report by 16 July 2004.

I understand that the Committee has invited submissions addressing the Terms of Reference from interested organisations and individuals.

My partner, John Sheahan, and I have been involved in numerous litigious matters involving bankrupts seeking to put assets beyond the reach of their creditors. We are particularly concerned with one particular mechanism, employed by a bankrupt as follows:

- The bankrupt is an accountant, and operates his practice through a family trust of which he is the trustee.
- The bankrupt's accountancy practice's profits rely on the bankrupt's own exertions and the exertions of the various people that the bankrupt employs in the practice.
- The practice makes significant profits each year, in the order of $200,000 after all costs.

- The bankrupt pays himself a salary (taken as drawings) which is at the threshold of the income contribution level, such that he is not required to make any significant income contribution to his estate.

- The balance of the profits are 'loaned' to the bankrupt's wife and used, inter alia, to service the mortgage on the family home, which property is registered solely in the wife's name.

The trustee, John Sheahan, instituted proceedings in the Federal Magistrates Court, seeking an order that the debt owed to the accountancy practice by the bankrupt's wife (approximately $400,000 for the period since the bankrupt committed an act of bankruptcy) was recoverable pursuant to section 139D of the Act.

The trustee was successful at first instance, before Federal Magistrate Raphael of the Federal Magistrates Court. The bankrupt appealed.

The Full Court of the Federal Court, constituted by a single Judge, Justice Carr, found that although the asset existed, and although it had derived from the exertions of the bankrupt, the bankrupt had not sought to recover the debt and had therefore not derived any benefit from the debt, as is required by the wording of section 139D. The High Court declined to grant special leave to appeal this decision.

I attach a copy of the judgments of Raphael FM and Carr J, for your information.

The only possible reason for the bankrupt operating his practice the way he does is to put assets beyond the reach of creditors. In my view, in circumstances such as those described above, the trust should simply be annihilated upon the debtor's bankruptcy. Failing this, the wording of the Act should be amended so that the bankrupt is not required to have derived a benefit from the asset – the ability to derive a benefit should be sufficient.

I note that section 139E might be thought to be relevant to the above circumstances. However, the way the Act is currently worded, it is necessary for all of the assets to have derived from the exertions of the bankrupt. Although in this case the bankrupt is in effect the sole proprietor, there is clearly some uncertainty as to whether the whole of the practice's profits derive from him, or whether it could be said that some of the profits were derived from the employees. From a practical perspective it would be impossible to calculate that part of the profit attributable to the bankrupt. Accordingly, because of the uncertainty of the meaning of the legislation as drafted, no action was taken pursuant to section 139E of the Act.

Yours faithfully,

IAN LOCK
Partner

Documents attached