Professions AUSTRALIA

Submission in relation to the

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

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Contact: Bev Clarke
Executive Director
Professions Australia
GPO Box 201
Canberra ACT 2601
Ph: 02 6257 6100
Fax: 02 6257 6111
Email: executivedirector@professions.com.au

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1 Introduction

1.1 Submission

This submission comments on the amendments proposed by Schedule 1 of the *Bankruptcy Legislation Amendments (Anti-avoidance and Other Measures) Bill 2004* (the "**Bill**"). The changes countenanced by the Bill impact upon all individuals and particularly upon professionals (from sole practitioners to members of large partnerships). This submission is made by Australian Council of Professions Limited trading as Professions Australia.. A list of our member associations is attached as Annexure A.

Given the limited time provided for making submissions, Professions Australia has not has the opportunity to consider in detail the impact of the amendments proposed by Schedules 2 to 5 of the Bill. Whilst harmonisation of family law and bankruptcy law is a laudable objective, careful consideration needs to be given to the proposed amendments, which may have far-reaching consequences.

1.2 Executive summary

(a) Policy objectives

The Bill arose following the report of a government inter-agency Taskforce on the use by high net worth individuals of bankruptcy and family law schemes to avoid payment of tax. However, the Bill goes beyond the original Taskforce objective of preventing bankruptcy from being used in this way.

The proposed amendments will adversely impact all individuals and will discourage third parties from engaging in transactions given the complexity of the amendments, their uncertain application and the greater risk of arm's length transactions being impugned..

The Bill is an overreaction to the perceived inability of one creditor, the Australian Taxation Office ("**ATO**"), to undertake effective recovery action against tax evaders or recalcitrant debtors. Instead of dealing with the ATO's problem with targeted, specific legislation or by exploring existing mechanisms, a blanket solution has been proposed with indiscriminate effect and apparently without due consideration being given to the ramifications of such a solution.

(b) ***Adequacy of existing law***

The Bill's stated policy objectives can be achieved without fundamentally changing the law. A proper analysis of the provisions of the *Bankruptcy Act, 1966* (the "**Act**") demonstrates that the amendments proposed by Schedule 1 of the Bill are not justifiable by claiming that the existing provisions are inadequate. In fact, sections 120 and 121 in particular already address the policy objectives described in the *Explanatory Memorandum* to the Bill (the "**EM**") through the trustee's ability to avoid certain transactions. The powers outlined in the Bill, in contrast, go beyond these policy objectives and are unduly oppressive and expansive.

(c) ***Unjustifiability of proposed amendments***

Many of the proposed amendments contained in the Bill are unjustifiable, regardless of the adequacy of the existing law, as they contravene established principles and policy and in certain instances are unconstitutional. For example, the Bill may lead to injustice as it does not require "tainted property" to have formed part of the bankrupt's estate and it enables the attacking of market value transactions and arm's length transactions in certain circumstances. There is also a possibility of multiple recoveries under the Bill, which may include recovery from unrelated, innocent third parties.

The intended retrospective effect of the Bill is also unjust. There is a general presumption against retrospectivity in ordinary legislative interpretation because of the unfair and undesirable consequences that retroactive legislation can lead to. The law, in order to be effective, needs to be clear and certain and able to be relied upon. People who have entered into transactions or arrangements entirely in accordance with the law in force at the time should be entitled to enjoy those arrangements without the risk that they will end up being unlawful. The Government has recognised this principle in the past and should continue to do so.

The presumption of a tainted purpose is another element of the Bill that risks significant and unjust consequences, particularly where the presumption requires only an *allegation* of tainted purpose by the trustee in order to apply. No factual evidence is required. The presumption is against established policy and is not necessary to achieve the stated objectives of the Bill. Further, existing powers of trustees to investigate transactions, along with the substantial presumptions in favour of trustees in the existing Act, provide adequate means to establish the illegitimacy of those transactions.

(d) Existing solutions

Existing solutions to the ATO's identified problem should be thoroughly considered and explored before enacting legislation with broad-reaching, indiscriminate and revolutionary effect. These solutions include utilising existing laws fully (which may be enhanced by additional funding to the ATO, ITSA and other trustees) and allowing time to determine whether certain solutions already implemented (such as amendments to the *Legal Profession Act, 1987 (NSW)*) will be effective. These options should be explored, rather than enacting legislation which will impact significantly and indiscriminately on all individuals regardless of the fact that the only problem identified by the Taskforce was the ATO's inability to collect tax debts from a small number of high income earners.

(e) Adverse effects of proposed amendments

Further consideration also needs to be given to the likely adverse affects of the amendments proposed by the Bill before giving effect to them. These include:

(i) creating uncertainty in business and commercial practices;

(ii) increasing the costs of professionals and, ultimately, the costs to consumers of the services provided by these professionals;

(iii) challenging transactions which were lawfully entered into by the parties to them; and

(iv) discouraging individuals from entering into professions and other business activities which create employment opportunities for others.

1.3 Structure of submission

This submission has been divided into commentary on the following:

(a) the policy objectives underlying the Bill;

(b) special issues affecting professionals;

(c) an examination of the existing provisions of the Act and their adequacy;

(d) the potential injustice of the Bill;

(e) the unjustified retrospective effect of the Bill;

(f) the conflict of the Bill with existing and well-established State Laws;

(g) the conflict of the Bill with Constitutional provisions requiring property to be acquired on just terms;

(h) the unjustifiability of the presumption that transactions are entered into for a tainted purpose;

(i) the negative commercial effects of the Bill if enacted; and

(j) potential alternate means by which the Bill's legitimate policy objectives can be achieved.

2 Policy objectives of the Bill

2.1 Taskforce Report

In January 2002, a report was issued by the Joint Taskforce on "The Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax" (the "**Taskforce Report**"). The Taskforce was established following the bankruptcy of several professionals with very high levels of tax debt (and very little other debt). The Taskforce's mandate was:

> *"to consider whether any changes should be made to bankruptcy and taxation laws to ensure bankruptcy is not used as a means to avoid tax obligations."*[1]

At the forefront of changes suggested by the Taskforce Report to deal with this issue are amendments to the Act.

2.2 Stated purpose of Bill

The primary objective of Schedule 1 of the Bill, as set out in its EM, is consistent with the stated objectives of the Taskforce Report. However, the Bill's mandate appears to be broader than originally anticipated. Its main purpose is described as being:

> *"to address the issue of high income professionals using bankruptcy as a means of avoiding their taxation <u>and other obligations</u>"*[2] (underline added).

The EM also reveals the aim of reaching behind asset protection structures, stating that:

> *"the amendments will provide creditors with improved access to assets which are substantially those of the bankrupt but which are held in the names of other entities"*[3].

As recognised by the EM:

1 Page 4 of the Taskforce Report.
2 Paragraph 9 of the EM.
3 Paragraph 9 of the EM.

"the amendments proposed by [the] Bill represent a fundamental shift away from the perceived legitimacy of the[se] arrangements."[4]

Such a change was not advocated by the Taskforce Report.

2.3 Departure from Taskforce objectives

As set out above, the stated purposes of the Bill have departed from the objectives of the Taskforce Report. The Bill seems to have built upon the original objective of preventing the use of bankruptcy to avoid tax liabilities. In this expansion, however, the Bill's objectives become too broad-reaching. The Bill purports to deal with matters which were not identified as problems and which consequently have not been subject to proper analysis. The result is the indiscriminate application of a "broad brush" solution to an isolated issue.

The Taskforce Report deals specifically with the special status of the ATO as a creditor. It notes that ordinary creditors whose debtors use bankruptcy to avoid paying their debts have no need for special protection. This is because:

"informed creditors can make commercial judgments about a person's creditworthiness in light of their asset position and should stand or fall according to the soundness of their judgment."[5]

Further, they may be able to use the self-help remedy of withdrawing services and "cutting their losses". The ATO, in contrast, is distinguished as follows:

"The ATO does not choose to extend credit; it tries to collect a liability imposed by statute. Nor can the ATO withdraw services if tax debts are not paid."[6]

This distinction has a valid foundation. The ATO is in an unusual position as a creditor - it does not have the same "choice" in terms of the parties it deals with, as it will have a creditor relationship with the majority of Australian citizens at some point in time, regardless of their creditworthiness.

4 Paragraph 16 of the EM.
5 Page 5 of the Taskforce Report.
6 Page 5 of the Taskforce Report.

2.4 Scope of the Bill

It may therefore be legitimate to propose a Bill providing amendments to existing law in order to deal with the ATO's unusual problem. However, it is not legitimate for these proposed amendments to have a substantial detrimental impact on individuals' credit relationships with persons other than the ATO. The Bill's current scope goes beyond the reform necessary to deal with the ATO's identified tax collection issues, significantly impacting upon bankruptcy and other law and individuals' established legal and substantive rights.

Further, before legislation with such dramatic and extensive effect is introduced, there should be adequate consultation with those involved with the administration of these types of laws and those intended, or likely, to be affected by these types of laws. There appears to have been insufficient consultation with affected parties prior to the Bill's release. Further, the Bill was released on 14 May 2004, but any submissions in relation to the Bill are required to be lodged by 18 June 2004 - that is, only a little over a month has been provided for public scrutiny of, and comment on, complex and wide reaching legislation. This is in spite of the fact that the website of the Insolvency and Trustee Service Australia[7] proclaims that "the Government is keen to ensure that there is an opportunity for Parliamentary and public scrutiny".

If it is the Government's genuine aim to ensure such scrutiny, more time should have been provided for comment, greater consultation should have been conducted, and a system of public education about the proposed changes should have been implemented. This is particularly so, given the complexity of the proposed changes, which affect the interrelationship between the proposed bankruptcy amendments and the *Family Law Act*. Additional time needs to be given to deal with the impact of such complex and wide reaching changes. In addition, as discussed throughout this submission, the Bill's impact will not be limited to the "high income earners" stated to be targeted. In fact, professionals represent only 1279 out of 23,360 bankruptcies in the financial year ended 30 June 2003[8]. The general population will also be

7 www.itsa.gov.au (last visited 16 June 2004)

8 Annual Report of the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 2002-2003 at www.itsa.gov.au/dir228/itsaweb.nsf/docindex/IG%20Annual%20Report%202002-2003?OpenDocument (last visited 16 June 2004)

affected by the proposed laws. As such, it is essential that the general public understand fully the implications of the Bill and that the Government comply with its mandate from the Australian people by informing them properly about the changes it proposes.

3 Special issues for professionals

3.1 Special issues affecting professionals

Unlike many businesses, a number of professionals are not able to engage in their profession with all the advantages of a limited liability company or other limited liability structure. Auditors, for example, are currently prohibited from practising in limited liability structures[9] while insolvency practitioners, such as liquidators, administrators, trustees, and receivers, must accept their appointments as individuals.[10] In general, professionals are unable, or are significantly less able than those involved in other businesses, to manage and restrict their personal exposure. This means that professionals engage in business on an uneven playing field when compared to other business people.

There has also been, and continues to be, a decrease in the level and affordability of cover offered to professionals, while for some services insurance cover is either excluded from policies or significant restrictions apply. At the same time there has been a substantial increase both in premiums and deductibles. The lack of reasonable access to insurance forces professionals either to leave the profession or to bear a higher level of risk personally, thereby increasing the risk of their bankruptcy.

3.2 Impact of liability and insurance issues

The increased risk of personal exposure, combined with the continued lack of available, affordable or sufficient insurance cover, has been recognised as having a serious impact on the business of professionals. This impact takes effect in a variety of ways, including:

(a) acting as a deterrent for quality individuals entering into the professions or being prepared to take on senior roles. In light of the increasingly complex nature of business, it is imperative that

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9 Section 1279 of the Corporations Act, 2001 requires an auditor to be a natural person. Although CLERP 9 proposes to allow incorporation of audit firms, these will have more restrictions imposed upon them than other businesses (e.g. in relation to the composition of their boards and dealings in their shares).

10 The Corporations Act 2001, requires administrators and receivers to be registered liquidators. Section 1279 of the Corporations Act 2001 requires a liquidator to be a natural person. Section 154A of the Act only permits an individual to apply to be registered as a trustee.

appropriately qualified and experienced individuals enter and remain in the professions;

(b) causing professionals to withdraw services in high risk areas such as financial planning, audit and tax advice, obstetrics and gynaecology, engineering and environmental services. The continuation of services in these areas is fundamental in a properly functioning regulated society;

(c) increasing the costs of professional services available to the public and business sector. The adverse impact of this increased cost is clear, particularly for those of lower socio-economic standing;

(d) causing professionals to engage in defensive procedures by providing a minimum level of services to clients. The adverse impact of a drop in the level of service provided is clear and would run counter to Australia's positioning of itself as an exporter of professional services and as an innovative service economy;

(e) discouraging professionals from providing pro bono services or becoming involved in not-for-profit organisations; and

(f) discouraging professionals from accepting higher risk or start up clients. This may inhibit the development of business generally and of the economy and, as noted above, would run counter to Australia's positioning of itself as an exporter of professional services and as an innovative service economy.

3.3 Corporate vs individual asset protection

Personal asset protection has long been accepted as a legitimate practice for those involved in companies. Shareholders and directors are immune from personal exposures except in extraordinary circumstances. The Legislature and the Courts have been reluctant to lift the corporate veil of a business where there has been no suggestion of impropriety by the shareholder or director concerned in the business. Indeed the existence of limited liability has encouraged business activity, generated employment and permitted exploration into activities (such as medical research) which might otherwise not be undertaken if individuals were required to risk their personal assets.

These same protections are not afforded to individuals who carry on business in their own name or in partnership with others. The proposed Bill will introduce legislation which discriminates against individual businesses, as parties dealing with individuals would be forced to grapple with the complexity of the provisions, their uncertain application and the greater risk of arm's length or market value transactions being impugned.

As demonstrated in section 4 below, the existing Act more than adequately addresses illegitimate asset protection strategies. The existing Act is already more rigorous in identifying impugned transactions entered into by individuals than the *Corporations Act 2001* (the "**Corporations Act**") is in relation to companies. In this respect, the existing Act already favours the creditor in its attempt to strike a balance between the interests of the stakeholders in the business and the creditors who deal with them. There is no legitimate reason for targeting individuals (professionals and otherwise) for treatment which is harsher than that administered in respect of entrepreneurs who can utilise limited liability structures.

4 Examination of the existing provisions of the Act

4.1 Voidable transactions in bankruptcy

Sections 120 to 121 of Part VI of the Act render void certain transactions against a trustee in bankruptcy. The primary rationale behind these sections is to unwind transactions undertaken when the bankrupt was insolvent or transactions entered into with the intention of defeating, delaying or hindering creditors. In addition, some legitimate transactions, undertaken when the bankrupt was solvent, are still able to be challenged under these sections where the transactions were undertaken for less than market value.[11]

4.2 Voidable transactions in corporate insolvency

A similar rationale appears to have been applied to the voidable transaction regime outlined in the Corporations Act in respect of companies. The transactions which may be rendered void on the application of a liquidator of a company are, for the most part, insolvent transactions - that is, transactions either entered into when the company is insolvent or which cause the company to become insolvent.[12] Transactions which are intended to defeat creditors may also be defeated by a liquidator[13], although, in order to be voidable, these transactions must also be insolvent transactions. Other provisions enable directors to become personally liable for debts of an insolvent company where the company incurs a debt when the company was insolvent[14] and transactions involving close associates of the directors to be challenged if they are uncommercial.[15]

4.3 Comparison of the Bankruptcy and Corporations provisions

The balance struck by the Corporations Act was to give the liquidator extensive powers to challenge transactions entered into at a time of insolvency. The Act, however, went further than the Corporations Act as it also permitted limited challenges to transactions entered into when the

11 Section 120 of the Act renders transactions entered into within 2 years of the commencement date of the bankruptcy void where they were entered into for less than market value even though the individual is solvent. See also Division IVA of Part VI discussed at 4.3(c)

12 Section 588FE of the Corporations Act, 2001. The definition of insolvent transactions is contained in section 588FC.

13 Section 588FE(5) of the Corporations Act, 2001.

14 Section 588G of the Corporations Act, 2001.

15 Sections 588FDA and 588FE(6A) of the Corporations Act, 2001.

individual was solvent even though the transaction was entered into with an arm's length party. The Act also did not confer upon a defendant to a trustee's actions the same defences as those available in a corporate context.[16]

The Act's reach already goes further than comparable provisions for corporations and provides trustees with substantial powers to challenge transactions perceived to be a form of illegitimate asset protection. An examination of certain specific sections of the Act is set out below by way of demonstration of these substantial powers.

(a) Section 120 of the Act

Section 120 of the Act renders void transfers of property which took place within 5 years of the commencement of the bankruptcy where the transferee gave no consideration for the transfer or gave consideration of less value than the market value of the property. The exception to this is if:

(i) the transfer took place more than 2 years before the commencement of the bankruptcy; and

(ii) the transferee proves that, at the time of the transfer, the transferor was solvent.

There are a number of important features of section 120. These are:

(i) transactions entered into in the 2 years prior to the commencement of the bankruptcy may be rendered void even if entered into when the individual was solvent. By comparison, insolvency is an essential requirement for most claims in a liquidation[17];

(ii) the onus is on a transferee for a transaction in the period 2-5 years prior to commencement of the bankruptcy to establish that the transferor is solvent. This position should be

16 Section 588FG of the Corporations Act, 2001 sets out the defences available to insolvent transaction claims. A party who enters into a transaction in good faith and for valuable consideration (or a party who in reliance on the transaction has changed its position) and without notice of insolvency of the company will have a defence. Significantly, the consideration given need not be market value. Defences to insolvent trading claims are also set out in section 588H.

17 Section 588FE of the Corporations Act, 2001.

contrasted with companies where the liquidators have this onus, although in some cases they will have the benefit of certain presumptions[18]; and

(iii) the definition of transfer of property is very wide. For example, a person who does something that results in another person becoming the owner of property that did not previously exist is taken to have transferred the property to the other person[19].

The proposed changes to the Act would significantly increase the already expansive scope of legitimate transactions able to be challenged. Significantly, third parties unaware of the purpose of the bankrupt in effecting the transfer will potentially have their transactions challenged years after the event. This possibility, along with the Bill's potential to create injustice, is outlined in section 5 below.

(b) Section 121 of the Act

Section 121 renders void transfers of property where the transferor's main purpose in making the transfer was to prevent, hinder or delay, that property being available to the transferor's creditors. The trustee must also demonstrate that the property would have become part of the transferor's estate or would have been available to creditors if it had not been transferred.

A transfer is not void if:

(i) the transfer was at market value;

(ii) the transferee did not know of the transferor's purpose; and

(iii) the transferee could not reasonably have inferred that the transferor was insolvent or about to become insolvent.[20]

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18 Section 588E of the Corporations Act, 2001.

19 Section 120(7)(b) of the Act.

20 Section 121(4) of the Act

There are also a number of important features to this section. These are:

(i) a transfer of property is defined in the same broad manner as under section 120 of the Act;

(ii) there is no time limitation for the recovery of a transaction rendered void by this section. This is to be contrasted with the Corporations Act where the equivalent transaction must take place within 10 years of the relation back day[21];

(iii) there is a presumption that the transferor's main purpose was illegitimate if it can reasonably be inferred from all the circumstances that, at that time of the transfer, the transferor was, or was about to become, insolvent[22]; and

(iv) the transferee will have no defence to the transaction if market value was not paid for the property. Thus a transferee who did not know of the illegitimate purpose and did not know of the insolvency of the transferor will still be subject to the application of section 120 if the property was sold for less than market value. This position should be contrasted to the provisions for liquidators - even in the case of defeating, delaying or interfering with creditors, a person who entered into a transaction with a company in good faith, for valuable consideration and without reasonable grounds for suspecting insolvency, will have a defence to the liquidator's claim[23]. Further, in the case of liquidation, the consideration by the transferee need not be market value (only valuable).

Similarly, a transferee who paid market value and did not know of the illegitimate purpose but knew of the insolvency will be subject to this section. Although the setting aside of a transaction at market value may be considered unjust since the bankrupt merely substituted one property for another, the injustice is ameliorated, in part, by the trustee being required

[21] Section 588FE(5) of the Corporations Act, 2001.

[22] Section 121(2) of the Act

[23] Section 588FG of the Corporations Act, 2001.

to pay to the transferee the consideration given by the transferee. This obligation does not exist under the proposed new provisions.

(c) Division IVA of Part VI the Act

Division IVA of Part VI of the Act entitles the trustee to apply for orders either vesting property held by an entity controlled by the bankrupt in the trustee[24] or ordering the entity to pay the trustee a sum of money being all or part of the entity's net worth.[25] The bankrupt must have supplied personal services to, or on behalf of, the controlled entity and must not have received market consideration for the services.

Like sections 120-121, Division IVA has a wide potential application;

(i) "personal services" is widely defined to be any service of a physical, intellectual or other kind supplied by the bankrupt. It is not necessary for the trustee to demonstrate that the bankrupt was an employee of the entity or that the services supplied by the bankrupt discharged an obligation of the entity to supply the services;

(ii) in the case of an application under section 139E, it is not necessary for the trustee to demonstrate that the bankrupt continues to derive a benefit from the estate of the entity. It is sufficient that the net worth of the entity exceeded by a substantial amount what might reasonably be expected to have been the entity's net worth if those services had not been supplied;

(iii) in the case of an application under section 139D, it is only necessary to demonstrate that the property was acquired as a direct or indirect result of, or of matters including, the supply by the bankrupt of the personal services. It is sufficient that the provision of services was one of the matters which contributed to the purchase of the property;

24 Section 139D of the Act.

25 Section 139E of the Act.

(iv) it is not necessary for the trustee to prove that the bankrupt intended to use the entity to defeat, delay or hinder creditors or that the bankrupt was insolvent.

4.4 Adequacy of existing provisions

When the existing sections 120-1 of the Act were introduced pursuant to the *Bankruptcy Legislation Amendment Act, 1996*, the Explanatory Memorandum to that Act considered that the proposed changes were to simplify bankruptcy law and to change the focus away from the intention of the parties to particular transactions to the nature of the transactions and their likely effect on creditors. To the extent that a person's intention in dealing with the property was relevant, objective criteria were laid down in order to permit the drawing of inferences as to the likely intention of the transferor of property.[26] The amendments to section 120 also accounted for the effect, or possible effect, on creditors of the entry of the person into the transaction concerned.[27]

Division IVA of Part VI of the Act also enables the trustee to access property to which the bankrupt had materially contributed but which was held by an entity with which the bankrupt was associated.

Sections 120-121 and Division IVA more than adequately address the policy considerations set out in the EM of protecting unsecured creditors from being prejudiced by the disposition of assets by a bankrupt in the period prior to the bankruptcy. Further, in some states, such as NSW, these sections are also bolstered by provisions which operate outside of insolvency. For example, section 37A of the *Conveyancing Act 1919 (NSW)* renders void dispositions of property engaged in with the intention to defraud creditors.

The expansion of a trustee's powers, as envisaged by the Bill, goes too far in a context where adequate redress already exists.

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26 Paragraph 23 of the Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill, 1996.

27 Paragraph 27 of the Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill, 1996.

5 Potential injustice of the Bill

5.1 Comparative injustice

The Bill unnecessarily complicates the existing voidable transaction provisions applicable in a bankruptcy, leading to uncertainty in relation to how they will be applied and adversely affecting the business community. As discussed in section 6, the Bill may also render void transactions which were lawful, and not voidable, at the time they were entered into by the parties.

5.2 Specific examples of unjust impact

Some of the other ways in which the Bill has the potential to create substantial injustice to parties are as follows:

(a) Tainted property not required to form part of bankrupt's estate

The Bill does not require the trustee to demonstrate that tainted property (or property able to be recovered by the trustee) would probably have formed part of the bankrupt's estate (contrary to the current requirement to do so contained in section 121 of the Act). In considering whether the property is tainted property, the Court is to assume that the property was owned by the bankrupt and then assess whether it would have been property divisible in his bankruptcy.[28]

Property may be tainted property for the purpose of the Bill even though the property would not have been part of the bankrupt's divisible property if the transaction was unwound. Accordingly, the parties will need to rely on the Court declining to exercise its discretion under the proposed section 139F by recognising the lack of contribution from the bankrupt.

This proposition is demonstrated by the following example:

[28] See for example, proposed section 139AI(2) of the Bill.

EXAMPLE

- A, who later becomes bankrupt, has set up a family trust structure with B;
- C is the trustee of the family trust;
- A wishes to use the structure for a tainted purpose;
- C is aware of A's tainted purpose;
- A does not supply any personal services to, or on behalf of, C;
- C acquires B's property for less than market value; and
- B's property is used as the family home for A and B.

RESULT

The application of section 139AM would result in the property being tainted property since:

- *the creation of a family trust may be seen as a scheme;*
- *A had a tainted purpose in connection with the scheme;*
- *C acquired property as a direct result of the scheme;*
- *the transfer of B's property to C is not an exempt full-value transfer as C was aware of A's tainted purpose; and*
- *A uses the property acquired by C as the family home.*

The property is therefore potentially recoverable in A's bankruptcy even though the property would never have formed part of A's bankrupt estate, nor did he contribute directly or indirectly to the purchase of C's property. It will be left to the Court to consider the exercise of its discretion and, hopefully, decline to vest B's former property in the trustee, as this would impact unfairly and detrimentally on B.

(b) Market value transactions may be attacked

The Bill may attack transactions which have been entered into by the bankrupt for market value without requiring consideration to be fully repaid by the trustee (in contrast to the existing Act). A full value transfer will only be exempt in narrowly defined circumstances. These circumstances are if:

(i) market value was given; **and**

(ii) either:

(A) the transfer took place more than 10 years before the date of the bankruptcy; or

(B) the transferee did not know that the bankrupt had a tainted purpose in transferring the property.

Both of the elements set out in (i) and (ii) must be satisfied.

Therefore, a transaction may not be exempt where the recipient paid full value but knew of the insolvency of the transferor, as the recipient will be taken to have known of the tainted purpose. The potential consequence is that the bankrupt's creditors may be unfairly advantaged by the transaction since not only do they receive the benefit of the consideration paid by the transferee but the Court may also make one of the orders set out in the proposed section 139D. The extent to which the market value of the property reflects the ultimate contribution (whether financial or non financial) of an entity other than the bankrupt is only one of the factors which the Court is required to take into account when considering making an order.[29]

The provisions setting out what constitutes tainted property, money or schemes generally require the bankrupt to have used, or to have directly or indirectly derived a benefit from, that property, money or scheme. However, the fact that the bankrupt may have continued to receive a benefit from the transaction should not be relevant in circumstances where full "tangible" consideration was paid by a party to the transaction.

In addition, there is also no clear indication of how section 139AFB(1)(b)(ii) (which requires the transferee to establish that he or she did not know of the tainted purpose) will operate when the tainted purpose is that alleged in section 139AFA(1)(b) or 139AFA(2)(b) - namely, that:

> *"it can reasonably be inferred from all the circumstances that, at the time of the payment, the bankrupt was, or was about to become, insolvent".*

[29] Proposed section 139F(1)(bb) of the Bill.

It is not clear if the Court will have regard to whether the transferee could reasonably have inferred this fact, as is presently required under section 121 of the Act. Failure to take into account the lack of knowledge of the transferee of the tainted purpose would lead to unfair results.

(c) ***Impugning of arm's length transactions***

The Bill may impugn transactions entered into at arm's length without ensuring that the consideration must be fully repaid by the trustee. This proposition is demonstrated by the following example:

EXAMPLE

- A buys a property from B at a bargain;
- A leases the property to B;
- B had a tainted purpose (of which A was not aware); and
- B later becomes bankrupt.

RESULT

The property will be tainted property even though B was solvent at the time of the transaction and A has organised its affairs in such a way as to enable it to purchase the property (such as sold other property or lost an opportunity to buy another property). Whilst the Court can take into account A's net worth and the hardship to A's creditors, the Court is not able to examine A's non monetary hardship or the effects of A rearranging his affairs to complete the purchase.

(d) ***Potential multiple recoveries***

The Bill may result in multiple recoveries where dispositions of the bankrupt's property occur through a number of parties, even though one party may have given market value consideration for the transfer. This is demonstrated by the following example:

EXAMPLE

- A transfers property to B at less than full value;
- B transfers property to C at full value;
- A always intended C to be the ultimate recipient;
- A continues to use the property;
- A had a tainted purpose;
- B and C both knew A was insolvent;
- A becomes bankrupt.

RESULT

The money held by B is tainted money under the proposed section 139AI(1)(g). Further, the property held by C is tainted property under section 139AJ. The matter will then be left to the exercise of the Court's discretion. This may result in hardship to C, regardless of the fact that only C has paid market value consideration for the property. For example, taking B's money may lead to hardship for B's creditors (since B is insolvent and B's creditors relied on his asset position) but taking C's property may not lead to hardship for C's creditors since C is solvent (C's contribution should be taken into account as one relevant matter under section 139(1)(bb)).

(e) Uncertainty of Results

The large number of discretionary matters to be considered by the Court will lead to uncertainty and inconsistent results. This proposition is supported by the following example:

EXAMPLE

- A and B jointly own their home;
- A is offered a partnership when the property is worth $1m but secures a mortgage of $800,000;
- A transfers the property to B;
- B uses B's income to repay the mortgage;
- A becomes bankrupt;
- At the time of bankruptcy, the property is worth $1.5m.

RESULT

There is no certainty of result. Will the trustee claim $100,000 (being A's share in the equity at the time of the transfer), or $350,000 (being A's original equity plus half the capital gain) or $750,000 (being half the value of the property)? How will the Court exercise its discretion given B's repaying of the mortgage from B's income?

5.3 Conclusion

Having regard to:

(i) the lack of firm guidelines given to the Courts about the manner in which they are to exercise their discretion; and

(ii) the lack of defences of the kind available to companies in a liquidation

(iii) the proposed retrospective effect of the Bill (see section 6); and

(iv) the presumption of a tainted purpose (see section 9)

the amendments should not be allowed as they have the potential to cause significant injustice to parties including those who have no relationship with the bankrupt.

6 Retrospective effect of the Bill

6.1 Proposed Retrospectivity

Section 5 of Schedule 1 of the Bill provides that the amendments proposed by Schedule 1 will apply to bankruptcies current at the time of, or beginning after, the commencement of the Bill. It will also apply to moneys paid, property transferred and schemes entered into before or after the commencement of the Bill.

For the reasons set out below, the Bill should not have any retrospective effect.

6.2 Power to pass retrospective legislation

It is clear that the Australian parliament has the power to pass retrospective legislation. This was plainly promulgated by the High Court in *R v Kidman*[30], and this power has been relied upon in a variety of situations in Australian legislative history. However, the power to make retrospective laws does not mean that the exercise of that power should be divorced from careful and principled consideration. *R v Kidman*, for example, while recognised as the authoritative statement on retrospective powers, also pointed out the potential policy reasons behind not making legislation retrospective:

> "*There are plenty of passages that can be cited showing the inexpediency, and the injustice, in most cases, of legislating for the past, of interfering with vested rights, and of making acts unlawful which were lawful when done ...*".[31]

Importantly, however, in other jurisdictions the aversion to retrospectivity is so entrenched that there are express provisions prohibiting legislation from having retrospective effect (see, for example, the United States Constitution in the context of criminal law or the French "Code Civile" in the context of civil law).

[30] (1915) 20 CLR 425.

[31] at 451.

6.3 Presumption against retrospectivity

It is important to note that in the absence of an express statement in legislation that it is intended to operate retrospectively, it is presumed that the legislation will operate only prospectively. The rationale for the presumption against retrospectivity is that it may result in unjust consequences.[32] The general rule of statutory interpretation was set out by Dixon CJ in *Maxwell v Murphy*:

> *"The general rule of the common law is that a statute changing the law ought not, unless the intention appears with reasonable certainty, to be understood as applying to facts or events that have already occurred in such a way as to confer or impose or otherwise affect rights or liabilities which the law had defined by reference to the past events."*[33]

The principle has been restated more recently, albeit in the context of criminal law (although equally applicable in the civil law context), in *Polyukhovich v Commonwealth*[34], where Toohey J outlined the rationale for the general principle against retrospectivity:

> *"All these general objections to retroactively applied criminal liability have their source in a fundamental notion of justice and fairness. They refer to the desire to ensure that individuals are reasonably free to maintain control of their lives by choosing to avoid conduct which will attract criminal sanctions; a choice made impossible if the conduct is assessed by rules made in the future."*[35]

Similar principles should apply to laws which have the potential to affect people's assets and dealings. Legislation should not be given express retrospective effect for the same policy reasons as are applied by the Courts in the interpretation of legislation. Some of the considerations that should be taken into account are discussed below.

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32 *Maxwell v Murphy* (1957) 96 CLR 261.

33 (1957) 96 CLR 261 at 267.

34 (1991) 172 CLR 501.

35 at 688.

6.4 Considerations in relation to retrospectivity

(a) General considerations

Palmer and Sampford summarise the types of general arguments that are often raised against retrospective laws:

> *"They are said to be unjust, undemocratic, unreliable and contrary to human rights, individual autonomy, the rule of law and the Constitution."*[36]

Some of these types of arguments are discussed below.

(b) Certainty and reliance

Palmer and Sampford's detailed article, entitled "Retrospective Legislation in Australia - Looking Back at the 1980s", considers in detail the types of laws which have had retrospective application and the appropriateness of retrospectivity in these contexts. Although supportive of retrospective legislation in some contexts, the authors note that:

> *"... the reliance argument is a very important one. Citizens form expectations that the law which will be applied to them, if their actions and transactions come to court, will be the law as it stood at the time they acted and transacted. Encouraging that reliance tends to make the law more effective and gives citizens the opportunity to plan ..."*.[37]

One of the goals of law is to provide certainty and, in order for the law to be effective, it needs to do so. If citizens enter into transactions in particular ways, based on what the law provides, they should be able to rely on those transactions remaining legal and unimpeachable.

In fact, Prime Minister John Howard has been known to take a stand publicly against retrospectivity of legislation on the principle of reliance. One example was Mr Howard's response to the intention of

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[36] Palmer, A. & Sampford, C. "Retrospective Legislation in Australia: Looking Back at the 1980s" (1994) *Federal Law Review* 217 at 223.

[37] at 276-277.

the Opposition Leader, Kim Beazley, to impose a retrospective capital gains tax. Mr Howard's criticism was based on the fact that the tax would be imposed on the assets of many retired people who (in good faith) believed prior to 1985 that they could deal with those assets free of capital gains tax. He stated that these people "have a right to be indignant about this change."[38]

Similarly, and more recently, Mr Howard has proposed changes to superannuation legislation for politicians with no retrospective effect on the basis that:

> *"It is a fair and reasonable and entirely defensible, indeed well arguable, proposition that people who enter into an arrangement for part of their career on a certain basis are entitled to enjoy the entitlements of that arrangements as they enter into them"* (sic).[39]

People who have entered into transactions, or arrangements, in respect of their assets, entirely in accordance with the law in force at the time should be afforded the same entitlements in respect of these arrangements as politicians in relation to their superannuation arrangements - that is, they should be entitled to enjoy the entitlements of the arrangements they have made as they were at the time the arrangements were entered into.

(c) Retrospectivity vs democracy

Retrospective law-making can also be seen to offend certain democratic principles as a government may end up legislating with an effect in a period prior to its election, and therefore prior to its mandate. The potentially limitless backwards application of the proposed amendments means that the current Government is proposing to legislate in respect of multiple periods when it had no mandate from the Australian people to make laws. The Bill proposes to legislate retrospectively in a broad-reaching way, irrespective of policy and legitimacy at the time of entry into transactions, which is inappropriate and in excess of the government's true mandate.

[38] "Retrospective CGT on Pensions Under Fire", *Australian Financial Review* May 29, 2000, p.47.

(d) Double jeopardy

The Bill's proposed retrospective effect risks a trustee who has been unsuccessful under existing provisions (such as, for example, by not discharging the relevant onus of proof) being entitled to bring a further, similar claim against the same defendant under the new provisions. Although the prior litigation may have created issue estoppels on certain aspects of the claim, the defendant could still face the increased cost of a second trial and may be in a weaker position as a result of strategic decisions made in the first trial as well as because of the different onus of proof in the second trial.

(e) Loss of relevant documents

As discussed in section 9 below, defendants may no longer have documents available to prove the legitimacy of transactions entered into prior to the introduction of the proposed changes. The unlimited retrospective nature of the amendments means that transactions may be affected in relation to which an individual did not keep (and has no obligation to keep) documents. This is particularly troubling when that individual has the onus of proving the legitimacy of a particular transaction.

6.5 Justification for retrospective laws

Arguably, there is a place in a legal system for the operation of retrospective laws. For example, it is generally recognised that there may be a need for "validating laws" to apply retrospectively for them to have any effect. There is no place, however, for retrospective laws that have an unjust effect. The proposed legislation is retrospective in the sense that it potentially alters the future legal consequences of past events. This effectively leads to a situation where a person undertakes a completely lawful transaction one day and the next has sanctions attached to that action. It is this type of retrospective law about which the most reservations are generally expressed.

6.6 Justification for Bill

According to the EM and as discussed in section 2 above, the problem which the Bill appears to be trying to solve is "the issue of high income

[39] "No super cut for me or you, Aust PM tells ALP's Latham", *AAP Newsfeed*, February 16, 2004,

professionals using bankruptcy as a means of avoiding their taxation and other obligations".[40] This flows from the Taskforce Report, which appears to have arisen following the bankruptcy of several professionals with very high levels of tax debt (and very little other debt). The inability of the ATO to collect tax debts efficiently seems to have given rise to broad amendments in the bankruptcy arena with an impact on individuals across the board (not just in the "high income earning professionals" bracket initially stated to be targeted). The amendments proposed are arguably for the sake of expediency, rather than in accordance with the principle and purpose of the law. Principle is being sacrificed merely to balance the budget or increase the revenue collections of the ATO.

6.7 Justification for retrospectivity of Bankruptcy Amendments

Paragraph 80 of the EM states:

> *"These amendments will have a retrospective effect. This retrospectivity reflects the policy underlying the amendments - namely, to challenge the legitimacy of asset protection upon bankruptcy. If these proposed amendments were not retrospective and applied only to bankruptcies and transactions occurring after commencement, it would it could (sic) be some years before they took effect. Moreover, the effectiveness of these provisions would be substantially undermined as individuals simply organised their affairs to avoid them."*

Accordingly, it appears that there are two main reasons for the intended retrospective effect of the amendments proposed by the Bill:

(i) to give immediate effect to provisions (rather than having to wait for transactions occurring after commencement); and

(ii) to prevent individuals from undermining the legislation's effect by reorganising their affairs.

Neither of these are valid justifications for going against the overriding principle against retrospectivity. First, even if the proposed provisions were acceptable (which is considered in other aspects of this submission), waiting

40 Page 3 of the EM.

for them to take effect and apply to transactions is a normal consequence of the introduction of new laws. It is the norm for laws not to have widespread immediate impact, particularly in a context such as this where transactions are involved. Impatience with the consequences of accepted past law is not a proper reason for accelerating the effect of new law by legislating retrospectively.

Secondly, as set out above, the scope of legislation should be set out clearly so that citizens can structure their affairs with certainty. The reorganisation of one's affairs following legislative change (to accord with the law) cannot, and should not, be prevented. Making legislation retrospective to ensure some transactions are captured is not an appropriate policy reason for retrospectivity. Moreover, if there is concern that a law may not adequately cover the relevant situations, the law itself should be reviewed and amended or drafted appropriately in the future.

6.8 Conclusion

Retrospective laws are only justified in exceptional circumstances. There is no such exceptional justification for the amendments proposed by the Bill. Citizens should be able to structure their affairs with the certainty that they are acting lawfully and without the fear that the law will be changed to make their past actions illegitimate. The Howard Government has previously espoused the importance of this principle and should not now overstep the bounds of its mandate to legislate inappropriately and contrary to established principle.

7 Conflict with existing law

The Bill proposes amendments which conflict with existing state law. No amendment should be permitted without due regard for the consequences to state law.

7.1 Inconsistency between State and Commonwealth laws

Section 109 of the Commonwealth Constitution provides:

> *"When a law of a State is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid."*

Accordingly, the operation of the law of the Commonwealth is paramount. However, given the significant impact of this provision on the effectiveness of State legislative autonomy, Commonwealth Acts which will lead to inconsistencies between State and Federal law should be given extremely careful consideration. This is particularly so where the laws to be impacted upon or "invalidated" have been in place for significant periods of time and are part of an established and well-recognised system.

7.2 Bill vs Torrens Title

The amendments proposed by the Bill will impact upon the Torrens Title system which is the keystone of modern Australian property law. It has been in force in New South Wales, for example, since 1862.

7.3 Indefeasibility under the Torrens system

Under the Torrens system, the registered proprietors of real property hold their legal interest "*absolutely free from all other estates and interests*" that are not recorded on the Register, except where:

(a) there is *actual fraud* on the part of the registered proprietor; or

(b) there is a claim against the registered proprietor in personam founded in law or in equity as the Court may grant.[41]

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[41] *Bahr v Nicolay* (No 2) (1988) 164 CLR 604; Sections 42 and 43 of the Real Property Act 1900 (NSW).

In *Bogdanovic v Koteff*[42], the NSW Court of Appeal recognised that a volunteer, registered on title, has indefeasibility of title with respect to land.

7.4 Bill's provisions

The Bill allows for the transfer back of property from third parties in certain situations upon application by the trustee in bankruptcy. Under proposed section 139D(2)(a), for example:

> *"The Court may, by order, vest in the applicant ... the property owned by the entity .... ."*

Clearly, this would conflict with the principle of the Torrens system that registered proprietors hold their legal interest free from all other estates and interests not recorded on the register.

While the Commonwealth may be empowered to legislate inconsistently with existing State legislation and thereby invalidate, or make inoperative, the inconsistent parts of State legislation, this should not be done without due consideration being given to the potential impact on the people regulated by State law, particularly where there has been reliance on that law for significant periods of time.

From the Taskforce Report, the EM and other materials issued by the Government, it is not apparent that any consideration has been given to the legislative inconsistencies that would be brought about by the enactment of the Bill. This should be done before any decision about enactment of the Bill is made.

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42 (1988) 12 NSWLR 472.

8 Unjust acquisition of property

The Bill proposes amendments which are not permitted by the Commonwealth Constitution.

8.1 Acquisition of property on just terms

Section 51(xxxi) of the Commonwealth Constitution authorises the Commonwealth Parliament to make laws with respect to:

> *"The acquisition of property on just terms from any State or person in respect of which the Parliament has power to make laws ... ".*

The acquisition of property need not be an acquisition by the Commonwealth Government - if a law of the Commonwealth is a law with respect to the acquisition of property for a Commonwealth purpose, the law is subject to the "just terms" requirement expressed in section 51(xxxi).[43] The "just terms" requirement has been found to be that "[u]nless it be shown that what is gained is full compensation for what is lost, the terms cannot be found to be just."[44] The entitlement to just terms must arise under the law by which acquisition takes place.[45] This may mean the law authorising the Court to fix the compensation which is to be paid to the person whose property is acquired by reference to an appropriate standard.[46]

8.2 Acquisition of property under Bill

The Bill is clearly Commonwealth law with a Commonwealth purpose. In addition, it provides for the acquisition of property from third parties (such as through a vesting order under section 139D(2(a)). It does not, however, provide for this acquisition of property to be on just terms. Nor does it incorporate a mechanism by which the Court must authorise compensation to a person from whom property may be acquired which would be commensurate with the "just terms" requirement.

[43] *P J Magennis Pty Limited v Commonwealth* (1949) 80 CLR 382.

[44] *Georgiadis v Australian and Overseas Telecommunications Corporation* (1994) 179 CLR 297 per Brennan J at 311.

[45] *Commonwealth v Western Mining Corporation Limited* (1996) 136 ALR 353 per Black CJ at 366.

[46] Note 45.

Although proposed section 139F requires the Court to take into account certain matters in deciding whether or not to make orders in relation to the acquisition of property (i.e. about whether and what to acquire), these matters are expressly limited and there is no prohibition on the Court ordering the property to be acquired if it sees fit. Once an acquisition has occurred, section 139H sets out the entitlement of the person whose property is acquired in relation to that acquisition. This section provides that if an entity's property is acquired, the entity may claim for a dividend in the bankruptcy in respect of the value of the property at the time the acquisition order is made. However, the entity's claim will be postponed to all claims of other creditors (including claims for interest on interest-bearing debts).

Being able to prove in a bankruptcy in respect of acquired property, after all other creditors have had their debts satisfied, can hardly be said to constitute just terms for that entity's property being acquired. This is particularly so given that such an acquisition may even occur when the entity has paid full market value for the property (in certain circumstances). It may also occur in a situation where a gift of property, such as to the bankrupt's child (occurring many years earlier when the bankrupt was solvent), has been relied upon in terms of future conduct of that child's organisation of his or her financial affairs.

9 Presumption of tainted purpose

9.1 Terms of the presumption

Sub-sections 139AFA(2) and (4) proposed by the Bill create a presumption that if the trustee alleges that a bankrupt or entity in a scheme had a "tainted purpose", it is to be presumed, unless the contrary intention is proven, that the relevant party in fact had such a purpose (the **"Presumption"**). Proposed sub-sections 139AFA(1), (3) and (5) specify the circumstances which will constitute such a tainted purpose.

The Presumption set out in proposed section 139AFA should not be implemented by the Act for the reasons set out below.

9.2 Presumption contrary to Ch III of the Constitution

Whilst the Presumption must ultimately be contextualised within the framework of a civil action, the notion of the bankrupt possessing a "tainted purpose" is tantamount to a quasi-criminal allegation of fraud. The fundamental tenet of the common law system in criminal procedure is the presumption of innocence until the guilt of the accused has been established beyond reasonable doubt.[47] In civil cases, where questions of criminal or other serious conduct arise, weight must also be given to the presumption of innocence and the usual requirement for exactness of proof.[48]

The rationale underlying the presumption of innocence is primarily the protection of the fundamental right to liberty, and specifically that:

(a) an innocent person not be found guilty of a criminal offence with all the grave consequences that erroneous condemnation would have for the accused, the system of justice and the community generally; and

(b) the prosecution treat the accused as an innocent person whose human rights must be respected.

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[47] *Woolmington v DPP* [1935] AC 462, 475; *Environment Protection Authority v Caltex Refining Co Pty Ltd* (1993) 178 CLR 477 referred to as a "fundamental principle" by judges in both the majority (Mason CJ and Toohey J at 502, McHugh J at 550) and the minority (Deane , Dawson and Gaudron JJ at 527).

[48] *Briginshaw v Briginshaw* (1938) 60 CLR 336.

As the presumption of innocence is a necessary concomitant of a fair trial (as indicated in various human rights instruments), it is increasingly open to debate whether the legislature is empowered to abrogate this fundamental principle by reversing the onus of proof, such as in the way proposed by the Presumption.

Comparatively recent case law indicates that provisions such as that creating the Presumption may in fact be unconstitutional (notwithstanding previous authority supporting the legislature's power to modify or reverse the onus of proof[49]). In this regard, Justice McHugh has recently argued extra-judicially that the power of parliament to affect quasi-substantive rights is open to serious doubt given the weight of judicial opinion over the last 15 years.[50] These quasi-substantive rights would include the presumption of innocence, the onus of proof resting on a plaintiff and the established standards of proof in civil and criminal cases while the use of deeming provisions and presumptions of facts would be examples of doubtful exercise of parliament's power.

This is because section 71 of the Constitution invests the courts with "judicial power". A provision such as that creating the Presumption arguably weakens and impairs the supremacy of the law in the administration of justice and constitutes a legislative usurpation of judicial power.

Moreover, a further implication of the Presumption is that the bankrupt or the affected party will be required to prove that there was, in fact, no tainted purpose. In addition to the fact that in the nature of things, a negative is generally more difficult to establish than an affirmative, the provision may potentially relate to transactions which occurred long ago. The defendant's ability to adduce evidence to dislodge the Presumption may therefore prove insurmountably difficult on account of factors such as:

[49] McHugh J, " Does Chapter III of the Constitution protect substantive as well as procedural rights?" (2001) 21 Aust Bar Rev 235 at 244:

> *"... At present the High Court case law also upholds the power of parliament to change the onus of proof in a criminal case or to declare that a state of facts is presumed to exist....But the cases that hold that parliament can do so were decided before the modern view of Ch II gained currency. Whether they would now be regarded as correctly decided must be an open question".*

[50] Note 49 at 238 - 239; see further *Re Tracey; Ex parte Ryan* (1989) 166 CLR 518 per Deane J at 580; *Leeth v Commonwealth* (1992) 174 CLR 455 per Mason CJ, Dawson and McHugh JJ at 470; *Chu Kheng Lim v Minister for Immigration* (1992) 176 CLR 1; *Actors and Announcers Equity Association v Fontana Films Pty Ltd* (1982) 150 CLR 169 per Murphy J at 214-215.

(a) the likely deterioration with the lapse of time of the memories of the bankrupt and others against whom claims are made; and

(b) the potential destruction or loss of documents. Record-keeping rules only require the retention of records for a variety of periods, the longest of which is 7 years. For example, the basic retention period for income tax records is 5 years after the records were prepared or obtained or 5 years after the completion of the transactions to which they relate. This period is reduced to 2 years for individual resident taxpayers with simple tax affairs.

The argument that the Presumption is unconstitutional is strengthened when it is considered that, contrary to the statutory defences set out in statutes such as the Corporations Act in analogous circumstances (as discussed in section 4 above), the Bill provides few substantive defences.

9.3 Presumption without proper factual foundation

The provision contemplates that the Presumption of tainted purpose may be raised without a sound factual basis, requiring only a mere *allegation* of tainted purpose by the trustee.

Whilst it may be argued that the trustee, as an officer of the Court, would not seek to invoke the Presumption without first establishing the requisite factual foundation, it is desirable from a policy perspective that the trustee undertake the relevant investigations to establish the factual basis for the allegation. It is conceivable, and in fact likely, that the constraints of time and resources might result in a trustee inadvertently "cutting corners" to receive the benefits of the Presumption, without utilising the powers specifically conferred on a trustee for the purposes of conducting such factual investigations, (as discussed in section 9.4 below).

Regard should also be had to the possibility of the Presumption resulting in cases being brought by the trustee with poor prospects of success. These cases may involve innocent third parties who are never able to recover fully their legal costs incurred in negating the Presumption (assuming they are able to do so), let alone the time and other costs involved.

Presumptions should in fact generally arise only where there are compelling reasons for placing the burden of proof on one party rather than another. In this way, presumptions embody the reasons for allocating the burden of proof. In particular, the rationale underlying a presumption must be highly persuasive, given its abrogation of the fundamental presumption of innocence.

This is the rationale behind there being *no* presumption under the Corporations Act that a transaction was undertaken for an illegitimate purpose. Rather, presumptions exist which are designed to facilitate the liquidator establishing insolvency at the relevant times. However, even in these cases, some legitimate reason must exist for the granting of the presumption. For example, in some cases, the Court will presume insolvency where the company failed to keep, or destroyed, company records required to be kept by the Corporations Act. The sound rationale underlying this presumption is to discourage the destruction of records, which would clearly make it difficult for the liquidator to prove insolvency of the company. In contrast, the justification in the EM is expressed in terms of:

> *"addressing the problem of high income professionals divesting themselves of wealth prior to bankruptcy while continuing to derive a benefit from that wealth"*

and does not provide a convincing rationale for the Presumption.

As a corollary, and further to the comments noted above, where there is no rational basis for a presumption, parliament has no power to require the court to act upon the presumption, as to do so is to undermine the judicial power vested in the courts.

While presumptions are a useful and common device for facilitating proof, the "justification for all presumptions is ultimately human experience of the association between the known and the presumed facts or circumstances".[51] It cannot be said that the common experience of parties conducting transactions in the circumstances outlined in the proposed provision is always

51 *Actors and Announcers Equity Association of Australia and Others v Fontana Films Pty Ltd* (1982) 40 ALR 609 per Murphy J at 641-642; see also *Calverley v Green* (1984) 155 CLR 242 per Murphy J.

for the tainted purposes specified, such that a presumption should automatically arise in every instance.

9.4 Presumption not required to achieve objective

The Presumption is not required in order for the Government to achieve its stated purpose of challenging the legitimacy of asset protection. The creation of the Presumption discourages proper investigation of claims by the trustee and ignores the extensive investigatory powers bestowed on the trustee under the Act to undertake extensive assessments as to whether the tainted purpose applied.

Previously, before embarking on actions, trustees would be careful to undertake a full investigation of the transaction to be impugned so as to form a rational assessment of the strength of the claim to be brought. The obligation of the trustee to review the position thoroughly ensured that the trustee only brought claims which had sound prospects of success.

In this exercise, trustees are assisted by the following powers conferred upon them by the Act:

(a) the ability to access the books of an associated entity[52];

(b) the ability to access the books of any person, or examine a person on matters connected with the trustee's performance of his functions under the Act[53];

(c) the ability to examine the bankrupt or an examinable person under oath.[54] An examinable person includes a person known or suspected to be in possession of the property of the bankrupt, a person believed to be a debtor of the bankrupt, a person including an associated entity or an associate of an associated entity who may be able to give information about the bankrupt or his affairs and any person who may have possession of books including books of an associated entity that may relate to the bankrupt or his affairs.

52 Section 77A of the Act

53 Section 77C of the Act

54 Section 81 of the Act

Under the Act, the trustee is not limited in the ways in which he or she can prove an illegitimate purpose in relation to a transaction. The Court will look at all the surrounding circumstances. In *Prentice v Cummins*[55] the Court inferred that the debtor had the requisite main purpose where his transfer of property left him without sufficient assets to meet his debts. It has also been held that the purpose may be reasonably inferred if the transfer was made at a time when the transferor knew of claims personally against him and it appeared that the transferor was concerned to protect property against those claims: *Worrell v Pix*[56].

Given the breadth of investigatory powers and the manner in which the trustee has been able to draw inferences, the trustee has not needed (and still does not need) a presumption which reverses the onus of proof on an essential element of the claim. The existing Act already gives substantial presumptions in favour of the trustee. Significantly, there is a presumption that the transferor's main purpose was illegitimate if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent. The fact that the trustee has the onus in other respects will ensure that actions which only have legitimate prospects of success will be pursued.

55 (No 5) [2002] FCA 1503

56 [2002] FMCA 93

10 Commercial effects of the Bill

10.1 General commercial uncertainty

The commercial uncertainty which the Bill would generate, if enacted, will significantly impact on lending institutions and financiers. This impact warrants specific consideration as set out below.

10.2 Impact on financial institutions

The broad scope of the Bill will adversely impact financial institutions and other creditors dealing with individuals. Creditors will effectively be placed on enquiry as to whether or not the property or money held by the debtor could be tainted property or tainted money in any person's potential or actual bankruptcy. This means that financial institutions will be discouraged from advancing credit unless satisfied that the security is unimpeachable. Financial institutions will accordingly be required to undertake greater due diligence into the borrower's security position. Increased due diligence by lenders will increase the costs of funding.

The particular implications of the Bill are discussed below.

(a) Financial institution on notice

Courts may be prepared to infer that the financial institutions have knowledge of the bankrupt's tainted purpose. This arises because financial institutions generally have information as to a borrower's:

- past income and resources (and also that of their partners);
- expected future income;
- resources for repayment of the loan.

Given the state of information available to a financial institution, the effect of the Bill is to place financial institutions on notice that property may be tainted property, irrespective of the name on the legal title. At the very least, financiers will need to make enquiries to satisfy themselves as to the vulnerability of any security taken.

(b) ***Implications for lending practice***

The uncertainty created by the Bill will result in a change in the nature of lending practices by financial institutions.

Given the inherently risk-averse and conservative nature of financial institutions, the Bill will potentially adversely impact lending practices, in that institutions will:

(i) refuse to provide credit facilities unless borrowers can demonstrate that security is not tainted property;

(ii) heavily discount the value of the security in personal lending calculations;

(iii) stipulate more stringent lending criteria, including requiring that loan repayments derive from the borrower's resources only; and

(iv) impose substantially higher establishment fees and interest margins due to the increased risk of advancing credit.

More specifically, the Bill will potentially lead to:

- a significant contraction in lending to individuals for business purposes;
- a substantial reduction, or elimination of, lending for working capital purposes generally secured over fixed assets; and
- substantially reduce or eliminate credit for high risk assets, such as shares, or for home improvements.

10.3 Failure to consider implications for financial institutions

The EM provides no supporting analysis or empirical data to indicate that the commercial implications referred to above have been considered. This is a significant omission by the Taskforce and warrants reconsideration of the Bill's impact on financial institutions with particular regard to the issues noted above.

11 Policy objectives may be achieved by alternative means

11.1 Alternatives for consideration

The policy objectives set out in the EM can be achieved by alternatives which will not result in a fundamental change in the law or the challenge to transactions which may have been entered into lawfully. Some of the suggested alternatives are as follows:

(a) to increase the resources available to the ATO so that it may pursue effectively persons engaging in tax avoidance;

(b) to increase the efficiency of debt collection procedures by the ATO so that it may recover unpaid tax cheaply and quickly. One way this may be achieved is by increasing the acts of bankruptcy available to creditors so that they do not require judgments to be obtained before the issue of bankruptcy notice. Similar principles to those applicable to statutory demands in the corporate context could be followed. Alternatively, introducing an act of bankruptcy arising from consistent failure to lodge tax returns might be an option;

(c) to increase the collection and cross referencing of information available to the ATO. For example, partnership tax returns already provide significant information to the ATO about the income earned by partners. The partners listed could then be cross checked against those who have filed tax returns. This would apply to a significant proportion (by income) of professionals such as accountants and solicitors. Introduction of systems by the ATO to use such available information would lead to identification of tax evaders at an early stage. In fact, it appears that this process has already begun. For example, last year the ATO obtained from the Architects Registration Boards, Law Societies and Accounting Associations in all Australian states and territories the lists of registered members, apparently for use in such a cross-checking system. A chance should be given for the efficacy of systems such as these to be tested before imposing the more complicated, broad-reaching and unjust system which the Bill proposes;

(d) to liaise with professional associations to devise other methods of monitoring the lodgment of income tax returns by individual professionals (where such a method of monitoring does not already exist);

(e) increasing the penalties associated with tax evasion or increasing the non-discharge period in a bankruptcy where serious tax evasion has been engaged in;

(f) increasing litigation funding for ITSA and other trustees to challenge transactions under the existing law, and to make sure the existing provisions of the Act are fully explored.

11.2 Existing alternatives

It is also important to note that the Bill gives little recognition to the steps already undertaken by professional associations to regulate the conduct of their professions. For example, in NSW, solicitors or barristers who engage in conduct to avoid tax may have their practising certificate suspended or cancelled. The *Legal Profession Act (NSW), 1987* (the "**Legal Profession Act**") now provides:

> *"A Council must refuse to issue, or must cancel or suspend, a practising certificate if:*
>
> *(a) the Council is aware that the applicant for or the holder of the practising certificate has, since being admitted as a legal practitioner, committed an act of bankruptcy or been found guilty of an indictable offence or a tax offence; and*
>
> *(b) the Council considers that the act of bankruptcy, indictable offence or tax offence was committed in circumstances that show that the applicant or holder is not a fit and proper person to hold a practising certificate."*[57].

[57] Section 38FC(1) of the *Legal Profession Act (NSW), 1987*

The grouping of bankruptcy and taxation offences with indictable offences suggests the seriousness with which bankruptcy and taxation offences are now being treated for members of the legal profession. Further, case law in relation to this section and other similar sections suggests that the Council's powers are not only being exercised, but that the Courts are also treating tax evasion or persistent failure to pay tax with extreme seriousness. In *Cameron v Bar Association of NSW*[58], for example, the cancellation of the barrister's practising certificate was upheld on the basis that his "consistent history of failure to comply with taxation obligations" and his "deliberate course of relegating the legitimate claims of the Deputy Commissioner of Taxation to the lowest priority" amounted to the requisite level of dishonesty to show he was not a "fit and proper person".

Clearly, remedies exist whose consequences are severe and have a strong deterrent effect. Existing mechanisms to prevent or discourage tax avoidance, such as those in the Legal Profession Act, should be reviewed and fully explored before the radical and indiscriminate measures proposed by the Bill are introduced.

[58] [2002] NSWSC 191 (20 March 2002)

ANNEXURE A

Member Associations of the Australian Council of Professions Ltd, trading as Professions Australia

Association of Consulting Engineers (ACEA)

Audiological Society of Australia (ASA)

Australasian Institute of Mining and Metallurgy (AusIMM)

Australasian Podiatry Council (APODC)

Australian Computer Society (ACS)

Australian Dental Association (ADA)

Australian Institute of Interpreters and Translators (AUSIT)

Australian Institute of Landscape Architects (ALIA)

Australian Institute of Quantity Surveyors (AIQS)

Australian Property Institute (API)

Australian Veterinary Association (AVA)

CPA Australia

Engineers Australia

Institute of Actuaries of Australia (IAAust)

Institute of Chartered Accountants in Australia (ICAA)

Institute of Management Consultants (IMC)

New South Wales Council of Professions (NSWCOP)

National Institute of Accountants (NIA)

Pharmaceutical Society of Australia (PSA)

Royal Australian Institute of Architects (RAIA)

Spatial Sciences Institute (SSI)