

Introduction

- 1.1 The exposure draft of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 (BLAAAMB 2004), together with an accompanying draft Explanatory Memorandum, was referred to the Committee on 13 May 2004 by the Attorney-General, the Hon Philip Ruddock MP, for inquiry and report in July 2004.¹
- 1.2 The Attorney-General requested that the Committee inquire into the provisions of the draft Bill, considering specifically whether the provisions adequately address problems identified in a Joint Taskforce Report on the *Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax* (January 2002).

Joint Taskforce Report

- 1.3 On 22 March 2001 the (then) Attorney-General, the Hon Daryl Williams AM QC MP, and the (then) Assistant Treasurer, Senator the Hon Rod Kemp, announced the establishment of an inter-agency Taskforce to consider whether any changes should be made to bankruptcy and taxation laws to ensure that bankruptcy is not used as a means to avoid tax obligations.²

1 The Committee was initially asked to report by 16 July 2004; given the large number of submissions received by this inquiry an extension was sought until the end of July.

2 Joint Taskforce Report on the *Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax*, Attorney-General's Department, Australian Taxation Office, Insolvency and Trustee Service Australia and Treasury, January 2002, p. 4.

- 1.4 The Taskforce consisted of officers from the Attorney-General's Department (AGD), Insolvency and Trustee Service Australia (ITSA), the Australian Taxation Office (ATO) and the Treasury.
- 1.5 The Taskforce identified the problem of a small but significant number of high-income debtors, typically high earning fee-for-service professionals, who use bankruptcy to avoid paying their taxation and other debts:
- These debtors have the ability to pay their debts but instead fund a lifestyle made possible only through the non payment of debts and the build up of assets in the names of related parties. Some such debtors divert income and other assets to other parties in a manner designed to thwart the capacity of the bankruptcy trustee to realise their value for the benefit of creditors. In such cases the return to creditors in a bankruptcy more often reflects the bankrupt's ability to structure their affairs in a certain way rather than their substantive or real wealth.³
- 1.6 This scheme only worked because the professionals concerned could continue to work in their professions as an undischarged bankrupt. Some barristers had failed to lodge tax returns at all, or for many years had failed to file.
- 1.7 The problems identified by the Taskforce formed the basis of the Terms of Reference for this inquiry:
- (a) high income earners using bankruptcy to avoid paying debts that they can afford to pay, while continuing to enjoy a lifestyle made possible through the build up of assets in the name of third parties
 - (b) the uncertainty arising from the interaction between family law and bankruptcy
 - (c) the inadequacy of the current income contributions scheme in circumstances where a bankrupt chooses not to comply, and
 - (d) the use of financial agreements to defeat the claims of creditors.

3 Letter, Attorney-General to the Hon Bronwyn Bishop MP, dated 13 May 2004.

1.8 The Taskforce made a number of recommendations for amendments to relevant Commonwealth legislation and administrative practices but the concept of ‘tainted property’ was not canvassed by the Taskforce. The original concept which was canvassed in recommendation 3 of the Taskforce Report was found to be unconstitutional.

1.9 The Attorney-General stated that the amendments proposed by the draft Bill are intended to address the issue of high income professionals using bankruptcy as a mean of avoiding their taxation and other obligations:

In particular, the amendments will provide creditors with improved access to assets which are substantively those of the bankrupt but which are held in the names of other entities (such as the bankrupt’s spouse or another family member). The amendments will also address longstanding issues concerning the interaction between bankruptcy and family law which have created uncertainty as to the competing rights of creditors and a bankrupt’s spouse.⁴

1.10 The amendments proposed in the draft Bill would implement a number of the Report’s key recommendations relating to the *Bankruptcy Act 1966* (the Act) and the *Family Law Act 1975* (the Family Law Act). There was nothing in the exposure draft of the proposed Bill to indicate the targeting of high income professionals. Evidence showed that the application would dramatically affect “ordinary punters” and have far reaching applications.

The Committee’s Inquiry

1.11 The Committee advertised the inquiry nationally and sought submissions from interested individuals and organisations.⁵

1.12 The Committee received over 180 written submissions and held public hearings in Canberra on 5 and 6 July and in Sydney on 22 July 2004.⁶

4 Letter, Attorney-General to the Chairman, the Hon Bronwyn Bishop MP, dated 13 May 2004.

5 The inquiry was advertised in *The Australian* on 19 May 2004 and placed on the Committee’s website.

General Observations

- 1.13 The Committee found general agreement that measures should be implemented to address the deliberate use of bankruptcy laws by high income earners to avoid tax and other debts. It also found that the ATO had been derelict in its duty in failing to identify tax defaulters, namely barristers who abused the bankruptcy laws to avoid paying tax.
- 1.14 However, 98% of the more than 180 submissions to the inquiry opposed the proposed amendments to the Act, whereby Division 4A of Part VI is proposed to be replaced with a new Division 4A.
- 1.15 The schedules relating to amendments to the Family Law Act in evidence were generally agreed with, or the submissions were silent.

Process of Consultation

- 1.16 Mr Ian Gilbert from the Australian Bankers Association stated that an edited version of the Joint Taskforce Report was made available to members of the Bankruptcy Reform Consultative Forum. The forum consists of representatives of the finance industry, lawyers, insolvency practitioners and includes a financial counsellor.⁷ According to Mr Gilbert the forum:

..has been looking at this proposal for some 15 months or more. There is... a level of concern from a majority of people on that forum that the bill is missing the mark.⁸

...the majority of the members on the forum were not supportive of tackling that problem in the way that is being proposed.⁹

- 1.17 However what was in the exposure draft was not part of this process.
- 1.18 The Committee understands that issues papers were prepared in November 2002 and July 2003 for consideration by the consultative

6 Appendix A contains a list of submissions, Appendix B contains a list of exhibits, Appendix C contains a list of witnesses at public hearings and Appendix D contains a list of Federal Court and Federal Magistrates Court cases where sections 120 and 121 of the Act have been considered (from 2000-2004).

7 ABA, *Transcript of Evidence*, 5 July 2004, p. 86.

8 ABA, *Transcript of Evidence*, 5 July 2004, p. 81.

9 ABA, *Transcript of Evidence*, 5 July 2004, p. 86.

forum.¹⁰ Notwithstanding ongoing resistance from members of the forum draft legislation was developed to address the problems identified by the Joint Taskforce.¹¹

- 1.19 ITSA advised that in September 2003 advice was sought from the Australian Government Solicitor on constitutional issues and found some elements of the proposed legislation to be unconstitutional.¹²
- 1.20 A revised proposal was developed in December 2003 and considered by the consultative forum.
- 1.21 Consultation with the Bankruptcy Reform Consultative Forum occurred on three further occasions prior to the release of the exposure draft currently under consideration by this Committee. Mr Bergman advised:

Shortly after the government made its announcement, we had a meeting of the consultative forum to explain the changes but not to discuss them. We convened a workshop on 4 February 2004, following a desire expressed by the forum members at the December meeting, to present and consider an early draft of this legislation. We spent the best part of the day discussing it with the parliamentary drafters present. On 9 March we had another meeting of the consultative forum, at which we talked at a fairly general level about some possible further changes, which have now been reflected in the exposure draft.¹³

- 1.22 The Committee found that the ‘further changes’ discussed at the March meeting included the introduction of the concepts of ‘tainted purpose’, ‘tainted property’ and ‘tainted money’.¹⁴

‘Tainted purpose’, ‘tainted property’ and ‘tainted money’

- 1.23 The Committee was advised that central to the proposed amendments are the concepts of a ‘tainted purpose’, ‘tainted property’ and ‘tainted money’.
- 1.24 The Committee notes that the concepts of ‘tainted purpose’, ‘tainted property’ and ‘tainted money’ are new concepts within bankruptcy

10 ITSA, *Transcript of Evidence*, 6 July 2004, pp. 25 – 29.

11 ITSA, *Transcript of Evidence*, 6 July 2004, p. 26.

12 ITSA, *Transcript of Evidence*, 6 July 2004, p. 27.

13 ITSA, *Transcript of Evidence*, 6 July 2004, p. 28.

14 ITSA, *Transcript of Evidence*, 6 July 2004, p. 28.

legislation. The originators of the concepts stated that they were unaware of them existing in any other jurisdiction.

- 1.25 The Committee is concerned that, given that the concepts are central to the proposed amendments to Division 4A, they were not central to the consultation process.