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The Secretary
House of Representatives Standing Committee
on Legal and Constitutional Affairs
Parliament House
CANBERRA ACT 2600
By Post and E-mail: laca.Reps@aph.gov.au

Dear Madam

Inquiry into the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004

Thank you for the opportunity to submit comment to the Committee's inquiry into the provisions of the above draft Bill. CPA Australia's detailed submission is attached.

If required, CPA Australia is willing to provide the Committee with additional information and would be pleased to present to the Committee at any public hearings it may hold. Questions concerning this submission should be directed to John Purcell, CPA Australia's Management and Business Technical Adviser, on Tel: (03) 9606 9826 or by E-mail: John.Purcell@cpaaustralia.com.au

Yours sincerely

G Larsen.

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Executive Summary

As Australia's largest professional body, with over 100,000 members, CPA Australia is committed to effective bankruptcy laws that provide a fair, equitable and organised system providing the best resolution for both creditors and the insolvent.

The objective of the Bill is to address the issue of high income earners using bankruptcy as a means to avoid taxation and other known liabilities. CPA Australia supports this objective and strongly enforces its own by-laws to protect consumers and creditors from this event. However, there is a need to minimise unintended consequences of the Bill, narrow its scope and provide more certainty for business.

Recommendations

CPA Australia recommends that:

- Greater reliance and confidence be placed on the proven self-regulating abilities of professional associations to prohibit the continuing in practice of bankrupt professionals, failing which the formalised mechanisms of the Bill should be applied as an exception.
- The retrospective aspects of the Bill should be applied to instances of serious tax evasion, elsewhere the Bill if pursued in its current form should apply prospectively.
- A particular category of debt and associated debtor behaviour should be recognised within the Bill's scope.
- In the development of bankruptcy recovery powers, the legislature needs to constrain the growing tendency toward disharmony between the treatment of personal and corporate insolvency.
- The Bill be drafted with a clear statement of overarching and specific sub-division objects.
- The Bill's provisions only apply on the basis of proven abuse or urgency. The narrowing of the Bill can be achieved through cross-reference between bankruptcy and taxation legislation with particular reference to reasonable exhaustion of existing taxation recovery mechanisms.
- That Courts dealing with matters brought before them be granted greater discretionary flexibility to redress adverse consequences affecting property rights.
- That greater consideration be given to the range of costs and financial impacts that will emerge as a basis for narrowing the scope of the amendments' application to the initially identified mischief.

1. Introduction

1. As Australia's largest professional body, with over 100,000 members, CPA Australia welcomes the opportunity to provide this submission to the House of Representative's Standing Committee on Legal and Constitutional Affairs' Inquiry into the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004.

2. CPA Australia supports the intent of the proposed Bill to penalise high income earners who use bankruptcy as a means of avoiding tax and other known liabilities. However, CPA Australia has significant concerns about the impact the Bill may have on a broader range of businesses and circumstances than those outlined in the Explanatory Memorandum. It is apparent that the scope of the Bill is broad, and will impact on more than half a million small business owners, sole traders, family trusts and partnerships. The Bill, if introduced as it stands, will have a negative impact on business confidence and investment.

3. CPA Australia also has concerns about the retrospective nature of the Bill which overrides existing business rules and penalises businesses that have relied on fundamental business conventions to manage their business affairs.

4. CPA Australia's submission addresses primarily item (a) of the Terms of Reference dealing with Schedule 1 "Amendments relating to tainted property and tainted money". The Terms of Reference are relatively narrowly defined in terms of an evaluation of the adequacy of the draft Bill in meeting the problems identified in the Joint Taskforce 2002 Report, however CPA Australia's submission does make wider reference to the nature, extent and appropriate response to the commercial abuse being addressed. This reference to the context within which the draft Bill was developed illustrates aspects of the appropriateness or otherwise of the proposed measures.

5. CPA Australia's submission has been developed from the perspective of the type of business structure through which accounting services are provided to the public which are typical of arrangements adopted by small and medium business across a wider of commercial undertakings. The draft Bill impacts on universally accepted rationales and principles of bankruptcy law. Similarly, the draft Bill lacks consistency with widely accepted approaches to business regulation and broader expectations as to the predictability of outcomes within a predominantly rule-based legal system.

6. The submission provides constructive recommendations to narrow the scope of the Bill to more closely address its stated objective.

2. Business risk and the general framework through which SME commercial activities, including professional services, are offered

Regulation should be targeted to known abuse of debtor/creditor relationships and formulated in such a manner as not to impede peoples' willingness to engage in commercial activity. The draft Bill in its current form fails these criteria of reasonable predictability of outcome and relative ease of interpretation. CPA Australia actively sanctions, through self-regulation, any member that continues to offer services to the public whilst bankrupt.

2.1 The form and nature of SME and professional services business structuring

7. In its January 2002 Report, the Joint Taskforce states in Appendix 3 (Professional Regulation) that while "*there is no regulation of the accounting profession*" member insolvency was subject to sanction under CPA Australia's professional conduct rules. It is appropriate to consider the effectiveness of self-regulation rules that may ameliorate against the Taskforce's suggested abuse amongst fee-for-service professionals of bankruptcy proceeds as a means of evading taxation liability.

8. Part 7 of CPA Australia By-Laws which governs the basis of members' capacity to provide public accounting services, identifies the following principal forms of practice through which such services may be offered by members holding a public practice certificate:

- sole trader
- partnership
- incorporated entity
- trust

9. The first two of these forms may be adopted for a variety of reasons ranging from convenience to a restriction based on the nature of the service being provided. Whilst both the Explanatory Memorandum (paragraphs 15 and 16) and the Committee's announcement of the Inquiry (page 2) identify the motivation of asset protection strategies being that of achieving outcomes analogous to limited liability, it is worth considering the nature of this motivation in terms of joint and several liability applicable to partnerships. The various State Partnership Acts contain terms similar to the following:

> *'where by any wrongful act or omission of any partner - - - the firm is liable therefore to the same extent as the partner so acting or omitting to act.'*
>
> and
>
> *'Every partner is liable jointly with his co-partners and also severally liable for everything for which the firm while he is a partner therein becomes liable'*

10. In these terms, asset protection seeks more to manage the risk of catastrophic commercial events by which one partner may be highly and disproportionately affected by another's acts or omissions. The notion of limited liability was granted to corporations as a state concession designed to encourage investment, promote reasonable commercial risk taking and the accumulation of wealth. Likewise, the significant economic and social benefit derived from the activities of sole traders and partnerships whose basis of protecting vital family assets and ensuring the succession of their business, should not be unreasonably encumbered by the presumption contained in the draft Bill that they have sought at the outset to defeat the claims of creditors or have a dominant purpose of tax evasion. This is particularly so where the identity of the creditor and the nature of the debt cannot reasonably have been contemplated.

11. Taxation liabilities can be anticipated from the outset, and therefore there is merit in granting powers to "look through" tax evasion motivated bankruptcy, though such powers, should be exercised in a well defined manner and after exhaustion of other avenues of recovery. Similarly, CPA Australia believes the Committee should give careful consideration to those aspects of the draft Bill that bring about a "disconnect" between the sanction of bankruptcy and either a clear objectively determined intent to defeat creditors or actions to prefer particular creditors in the period leading up to bankruptcy.

12. CPA Australia By-Laws at 712 and 714 specify that where practice is through either a trust or incorporated entity, that the "conduct of the practice is not impaired in any way by the trust arrangement" and that the member remains "strictly responsible to CPA Australia for the conduct of the incorporated entity." As such the investigation and disciplinary procedure around a member becoming bankrupt is unaffected by form of practice through which accounting services are offered to the public. Specifically, Clause 27(1)(f)(i) and (ii) of the CPA Australia Constitution makes it an offence to be a bankrupt within the terms of the Bankruptcy Act or any like law in a place outside Australia, or where offered through an incorporated vehicle, subject to the appointment of a Receiver or brought within any of the procedures or arrangements dealt with in Chapter 5 (External Administration) of the Corporations Act. Persons so affected are unable, amongst other penalties, to hold themselves out as CPAs being preclude from using the Body's brands and other intellectual property.

13. An analysis of CPA Australia's investigation process in the five year period to 2004 indicates of the 274 members disciplined, only twelve committed breaches of Clause 27(1)(f)(i) or (ii); ten being suspended or membership forfeited until discharged from bankruptcy, the remainder subject to lesser penalty applied at the discretion of the Disciplinary Committee.

14. It is reasonable to conclude therefore that the magnitude of either debtor or sequestration based bankruptcy arising out of habitual large debt taxation evasion has been an isolated occurrence, and that moreover, the public can be confident of self-regulation amongst professional bodies that sanctions such behaviour and presents a strong disincentive. The capacity for self-regulation forms an important cornerstone of small to medium size business practice in that it is reasonable to expect that the vast majority of business people actively comply with the letter and spirit of the law. In these terms, lower levels and less complex regulation targeted at significant excepts to the standards of commercial behaviour are clearly preferable to that presented in the draft Bill.

15. CPA Australia therefore argues that the Committee should give careful consideration to various measures that would draw its application closer to its original objective through valid narrowing of its scope of operation. Such an approach would be consistent with endeavours designed to simplify compliance for SMEs, to encourage investment and participation at this vital level of economic activity.

16. It is appropriate to note that where professional practice is conducted through an incorporated entity, the directors are subject to the full rigor of the Corporation Act. In particular, those sections dealing with insolvent trading (s 588G) that may make the director personally liable to compensate the company for losses (s 588J) and attract both pecuniary penalty (s 1317G) and disqualification from managing a corporation (s 206C) are relevant. Additionally the more general civil obligation of the duty of care and diligence is likewise developed around notions ensuring an ongoing capacity to meet debts as and when the fall due.[1] Further development of business regulation, in CPA Australia's view, needs to be cognisant of the wider framework governing the behaviour of participants so that change where it occurs is highly targeted and preferable incrementally based.

2.2 The rationale and principles of bankruptcy law

17. The current framework of laws governing both individual bankruptcy and corporate insolvency has evolved over many centuries. Amid the complexity of present day regulation, the following can be regarded as universally accepted rationales for the institution of bankruptcy:

- "the need to provide, where people are insolvent, some fair, organized and adequate system where the assets of the insolvent are collected and distributed to creditors, but on an equal basis - - -
- permitting a person who is in a hopeless financial position to obtain relief from the pressure of creditors - - -
- providing for the investigation of the insolvent and his or her affairs - - -
- providing benefits and safeguards for the community in that insolvents are restricted in the financial and other activities in which they are engaged."[2]

18. With the above as an accepted framework, Professor Keay presents bankruptcy as serving a crucial function balancing stakeholder interests so that:

> *while bankruptcy might be thought of as providing a resolution for a creditor/debtor problem, it is also the instrument used to settle the aims and needs of the competing interests, and it does in a very real way serve a social function.*[3]

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[1] see for example *Daniels v Anderson* (1995) 16 ACSR 607 at 661 to 664 in which Clarke and Sheller JJA examine a line of insolvent trading case as exemplifying the changing expectations as to the standard of director negligent related behaviour.

[2] A. Keay, "Balancing Interests in Bankruptcy Law" (2001) 30 Common Law World Review (2) p 206.

[3] Ibid at p 207.

19. Considered in these terms, there is little if any nexus in the draft Bill between the type of debtor behaviour being targeted and the creditor most directly affected. The following analysis of specific aspect of Schedule 1 of the draft Bill presents CPA Australia's concerns and, where appropriate, suggestions as to how the proposed arrangements might be modified to target the specific creditor/debtor problem of tax evasion induced bankruptcy and in so doing better serve its intended social function.

3. Analysis and comment on specific aspects of the draft Bill

20. The following scenario serves to illustrated the type of adverse or unintended consequence that may ensue from the current form of the Bill's proposed provisions.

A married couple lived and managed an orchard property, conducting their business as a partnership. The title of the property was held in the name of the wife. Typical of a small family business, as their children approached adulthood, each was admitted to the partnership without payment of goodwill or subscription to capital. In their teens, the children had assisted the family in working the property without receiving wages.

The business grew over a number of years enabling a further allotment to be purchased. In addition, the family lent one of the children sufficient cash to commence building a dwelling on the second property. This second property was held in trust for the benefit of the children to assist in the continuity of the family in the orchard business. Over the years substantial investment had been made in capital equipment, all of which were transferred from the partnership to a family owned service company.

Unbeknown to the family, an orchardist on an adjacent property had been supplied with a new variety of apple which proved to bear a highly transmittable fruit disease. Because of its proximity to the disease outbreak, the family was precluded by regulation from selling their produce in significant parts of their market.

Being a highly cashflow sensitive business, to "keep things afloat" the head of the family decides to delays payment to a range of creditors of both the partnership and the service company, including the ATO, though the critical point is reached after a number of months when the supplier of fuel to the service company serves a statutory demand under s 459E of the Corporations Act.

The above scenario illustrates a potential breach of a range of obligations, the financial failure is nonetheless caused by an unanticipated catastrophic business event. Whilst a body of rule exists to treat the outcomes of this business failure it is unreasonable that the additional powers anticipated in draft Bill might also be brought to bear as an alternative.

3.1 The draft Bill's commencement of operating effect

The retrospective nature of the draft Bill will unduly undermine reasonable expectations as to the certainty of business structuring. To redress negative consequences, CPA Australia suggests the provisions be applied retrospectively in relation to tax evasion and otherwise prospectively. Additionally, the furthering of disharmony between the treatment of individual and corporate insolvency, brought about by the Bill should be viewed with caution.

21. Clause 2 of the Bill presents a commencement day for the coming into effect of each of the Bill's schedules – the provisions of Schedule 1 deemed to commence on the day of Royal Assent. This particular aspect of the Bill's coming into force is dealt with in paragraph 89 of the Explanatory Memorandum where the rationale for the amendments having a retrospective effect are stated as justified on the grounds of avoiding any delay in a trustee's capacity to attack asset protection arrangements and to preclude individuals reorganising their affairs to avoid the provisions.

22. Notwithstanding the merits of this objective in narrow circumstances of tax evasion abuse of bankruptcy protection, the scope of retrospective effect should be tempered to protect those many individuals who have structured their business and personal affairs with an honest intent around which the circumstances may now be radically changed.

3.2 A general perspective on the efficacy of retrospective legislation

23. A fundamental notion contained in the principle of the Rule of Law, which at least at a philosophical level should guide the development of law, is that rules should satisfy the criterion of being prospective so as to support the stability and certainty of the legal framework. Within this framework a distinction can be drawn between substantive laws, such as that contained in the draft Bill which regulate people's rights and liabilities, and procedural laws which prescribe the manner and form of legal proceeding and judicial forum. Procedural laws tend by inference to be retrospective in nature[4], whereas greater caution is required in defining retrospective effect of substantive law to ensure its targeting of an identified mischief or abuse.

3.3 The specific characteristics of debtors entering bankruptcy

24. The scope for either unintended consequence or the unfair "casting of the net" to capture persons and their arrangements to which the Bill's provisions may be prone, can be considered in the context of an understanding of the kinds of debtors who enter bankruptcy.

[4] See for example *Advent Investors Pty Ltd v Goldhirsch* [2001] VSC 59 where Warren J, though dealing with a non-insolvency matter (that of the Corporations Act Part 2F.1A statutory derivative action) took the view that procedural statutes apply retrospectively unless there is a clear legislative intention of a prospective limitation. (refer A. White CCH Bulletin No 44 April 2001).

25. The more the provisions enable bankruptcy trustees to "reach further back" beyond the actual event of bankruptcy to recover property and money or undo specific arrangements entered into, the more it is fair to surmise that honest but unfortunate business people will be tarnished with the stigma of bankruptcy. The idea that bankruptcy law might cater differentially between "fraudulent" and "unfortunate" debtors is not novel. Professor Keay concludes that "those who are unfortunate (should) not, as they often are at present, be seen in much the same light as the fraudulent and /or reckless who become bankrupts."[5] Such flexibility would in no way derogate against the rationale of bankruptcy outlined above.

26. Within this context, the Committee should give consideration to measures which narrow retrospective application to a class of fraudulent debtor (possibly those having sustained large scale tax debts) that can be identified with some degree of objectivity beyond the assertion of a trustee. If a wider application is insisted upon for non-fraudulent debtors, this group should only be affected on a prospective basis.

3.4 Divergence in legislative regimes

27. A further area of caution raised in relation to the retrospective nature of the proposed provisions, is the extent to which the draft Bill adds to the already present divergence between the treatment of personal and corporate insolvency.

28. This divergence is particularly apparent in the respective law's time zones for treating the recovery of antecedent transactions. Aside from fewer time thresholds provided in the Corporations Act, the corporate voidable transaction arrangements (s 588FE) are already distinguishable from the bankruptcy counterpart (s 121); the latter operating without time limit, a power strengthened further in the draft Bill's proposal to enable the setting aside of any non full value transfers taking place more than 10 years before the date of the bankruptcy (proposed s 139AFB(1)(b)(i)).

29. Whilst it is unlikely that Australia will embrace a merging of personal and corporate insolvency into one body of statute[6], the draft Bill's compounding of divergence ignores both the regulatory and market efficiency gains that might be achieved through the promoting of greater harmony.

[5] "Bankruptcy Law Reform and Distinguishing Between the Kinds of Debtors Who Enter Bankruptcy", (2000) 8 *Insolvency Law Journal* 63 at 69.

[6] see for example – Andrew Keay, "The Unity of Insolvency Legislation: Time for a Re-think?" (1999) 7 *Insolvency Law Journal* 4.

4. Consistency between the draft Bill's objectives and structure of arrangements

CPA Australia suggests that consistent with the drafting of other statutes, consideration be given to inclusion of objects both at an overarching level and in relation to specific key operating sub-divisions or sections that provide the mechanics of the proposed regime.

30. Proposed s 139AAA "Simplified outline", expresses the scope of recovery powers granted to Courts and the matters to which regard must be given in relation to the targeted purposes. However, it does not state an objective of the legislation. Given the breadth and potential reach of the legislation, absence of clearly articulated objects either at an overarching level or within individual Subdivisions complementary to that articulated in the Explanatory Memorandum (noting in particular paragraph 9 and 11 under the respective headings "Policy objectives" and "Recovery of property of third parties") unduly detracts from an individual's capacity to plan their affairs with certainty. It may also provide insufficient guidance as to how the courts will treat trustee claims pursued under these greatly enhanced powers.

31. CPA Australia urges the Committee to give careful consideration to the various suggestions presented below which would assist in drawing the Bill closer to addressing the identified mischief and in particular clearly defining the relatively subjective terms "high income" and "professionals" used in the Explanatory Memorandum.

32. Significant emphasis is given both in the Explanatory Memorandum and throughout much of the research leading up to the Taskforce Recommendations, to the use of bankruptcy as a means of avoiding taxation obligations. Whilst the Explanatory Memorandum does refer to "other obligation" along with evasion of longstanding and substantial taxation liabilities, it must be acknowledged that the impetus for the changes relate overwhelming to the latter taxation issues. As such it is reasonable to question whether the Bill provides an unnecessary augmentation to the existing extensive investigation and recovery powers of trustees that might therefore be invoked or availed of in response to an abuse of taxation obligations.

33. Bankruptcy is, by its nature, a collective proceeding. The proposed powers should only be availed of by the Australian Taxation Office after it has either fully or reasonably exhausted its various extensive recovery powers or where a court is satisfied that the tax debtor's behaviour warrants immediate and extensive recovery action. Additionally, to redress the very real concerns as to the unlimited retrospectivity, it may also be appropriate to ensure the ATO initiates its action in a timely fashion, achieved possibly with reference to the timeframe of taxation record retention requirements.

5. Aspects around the notion of "tainted purpose"

34. The new Division 4A has been proposed against the background of perceived shortcomings in the current Division 4A of Part VI of the Act and is aimed at enhancing the ability of trustees to recover property held by third parties (refer paragraph 13 of the Explanatory Memorandum). However, much of the wording of proposed key operating sections (in particular s 139AFA Tainted purpose – payment of money or transfer of property) – are drawn directly from s 121 Transfers to Defeat Creditors.

35. As the pivotal operating section, proposed s 139AFA defines a tainted purpose against which a trustee may apply to the Court seeking either vesting or sale orders (refer generally Subdivision C – orders in relation to tainted property or tainted money). The proposed section commences with two objective tests of a bankrupt's main purpose – firstly that of preventing, and secondly, hindering or delaying money or property becoming divisible among creditors[7]. This is followed by an equally ranking subjective test of a reasonable inference that at the time of transfer or payment the bankrupt was about to become insolvent. This latter test, in the context of s 121, forms a qualification on the objective tests. Of further significance is subsections (2) and (4) of proposed s 139AFA which establish a presumption of a tainted purpose at the allegation of the bankrupt's trustee.

36. The validity and effect of these wide ranging powers is considered in CPA Australia's submission under the following headings; Appropriateness to the initial abuse, Impact on assumptions of property rights and Various consequences leading to significant financial impact.

5.1 Appropriateness to the initial abuse

To ensure that recovery procedures available under taxation legislation are fully and fairly applied in the first instance, CPA Australia recommends the Bill's provisions should only apply by default on the basis of reasonably proven abuse or urgency.

37. The opening words of the *Policy Objective* presented in the Explanatory Memorandum are:

> *The amendments proposed by this Bill are intended to address the issue of high income professionals using bankruptcy as a mean of avoiding their taxation and other obligations.*

The centrality of tax evasion as the abuse or ill being redressed by the reform process is again evident from the Joint Taskforce's Report:

[7] s 139AFA(1)(a)(i) and (ii)

> *A small but significant number of high-income tax debtors, typically high earning fee-for-service professionals, use bankruptcy to avoid paying the tax that they owe according to law.*

and further,

> *Typically the ATO is the sole or most significant creditor and the dividend distributed to creditors by the trustee in bankruptcy amounts to only a few cents in the dollar.*[8]

38. Aside from highlighting the subjective and potentially arbitrary nature of the draft Bill's application to an array of small businesses and professionals who are neither high income earners or engaged in any way in taxation evasion, the above remarks raise further concerns as to the consequences of augmentation to the ATO's already extensive recovery powers. It is acknowledged that the ATO, whilst vested with the critical responsibility of fairly and efficiently recovery tax liability across a vast spectrum of activities and taxpayers, is nonetheless an involuntary creditor ranking on an equal footing with other unsecured creditors.

39. A fundamental corollary to the rationale of bankruptcy law to maximise returns, is the imposing of rules which equitably rank creditor claims to a distribution. As such there is "convert(ed) creditors' rights of action into rights of proof in competition with other creditors"[9] so that all creditors of equal ranking are enabled to participate in the common pool in proportion to their admitted claims (*pari passu*).[10] Conceptually in terms of debtor / creditor relationships, where the unsecured creditor is involuntary or non-adjusting "their debtors will not bear the full cost of defaulting and will not take optimal care to avoid default."[11] In these terms the complex range of registration, collection and recovery powers contained variously in Part VA through to Part VII of the Income Tax Assessment Act 1936, provides a comprehensive framework to address in the majority of instances undesirable incentive aspects of the ATO /debtor relationship.

40. CPA Australia is of the view that further augmentation to these powers should be treated with caution in that:

> *'A further factor which is relevant in assessing the efficiency of granting protection to certain unsecured creditors is the creditor's ability to monitor the debtor's performance thereby preventing the debtor's defaulting or taking inefficiently low levels of care.'*[12]

41. Existing collection and debt recovery arrangements would in the majority of instances provide the ATO with sufficient capacity to efficiently monitor and intervene to forestall the abuse characterised in the Taskforce report. Exceptions, such as there are, should only be treated in the manner proposed in Bill as the final point in a hierarchy of recoveries.

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[8] Executive Summary p 4.

[9] R.M. Goode, *Principles of Corporate Insolvency Law* (1990 2nd ed. Sweet & Maxwell, London) p 31.

[10] ibid at p 141.

[11] V. Finch and S. Worthington, "The Pari Passu Principle and Ranking Restitutionary Rights" in F. Rose *Restitution and Insolvency* 2000 Mansfield Press London, p 3.

[12] Ibid p 4.

42. Aside from narrowing the draft Bill's application to specific debtor / creditor relationships at the centre of the abuse being attacked, consideration should also be given, perhaps through complementary amendment to the Income Tax Assessment, to requiring reasonable exhaustion of collection processes, or the demonstration of an urgent need to depart therefrom.

43. "Cross-referencing" between the Income Tax Assessment Act collection and recovery procedures and insolvency law is by means without precedent. S 222AOB(1)(c) makes reference to the appointment of an administrator as provided for in Part 5.3A of the Corporations Act. It is noteworthy that decisions around this aspect of taxation administration have been critical[13] of both the ATO's "tardiness" and "belated zeal" in pursuing outstanding debt, thus adding weight to concerns that additional powers be applied in a highly targeted and predictable manner.

5.2 Impact on assumptions of property rights

It is evident that the extent to which the draft Bill cuts across notions of property rights warrants consideration being given to increasing the Courts discretionary powers to review matters specific to a particular bankruptcy. One mechanism by which this sensitivity to particular circumstances could be achieved is through enabling greater, though well targeted, flexibility around the concept of non-divisible property.

44. The indefinitely retrospective aspects of the draft Bill within which trustees in bankruptcy are granted relatively unfettered powers to seek either the vesting (proposed s 139D(2)) or sale (proposed s 139D(3)) of property pose significant concerns as to expectations of property rights. This is particularly evident where the events giving rise to the purchase or formation of the property are highly remote in time from the event of bankruptcy and where the debtor cannot reasonably have had in contemplation those who would be creditors in the lead up to or upon insolvency.

45. Traditional views of personal property rights protected within a legal framework hold that:

> *'an owner is vested with absolute powers within rigid boundaries'*

and that

> *'an owner is seen as necessarily enjoying all the entitlements in the bundle of rights that is property: the rights to use, to exchange, to derive income, to exclude and to be immune from expropriation.'14*

[13] *DCT v Saunig* (2002) 43 ACSR 387 at 399 per Heydon JA

[14] Craig Rotherham *Proprietary Remedies in Context* (2002) Hart Publishing Oxford – Portland Oregon p 35.

46. Within this conception of the law, there is observed a dichotomy of responsibility within which courts enforce property rights and contracts, whilst redistribution of property remains within the primary province of the legislature.15

47. The branch of law dealing with the rights of governments to enact laws which result in the expropriation of property for public or related purposes (eminent domain) is underpinned by notions of just terms (Constitution s 51(xxxi)). The Commonwealth's power to enact laws with respect to bankruptcy and insolvency (s 51(xvii) is one of "those which have been held by the High Court to stand outside or to have excluded the operation of s 51(xxxi) because of their subject matter."16

48. Existing bankruptcy property recovery laws are predicated on the debtors objectively determined assailable purpose, whereas the shift to reliance on the assertion of a trustee central to the scheme proposed in the Bill potentially encroaches on the reasonable expectations of individuals, outside any foreseeable event of bankruptcy, to structure their affairs as they wish.

49. CPA Australia acknowledges the endeavours expressed in the Explanatory Memorandum (paragraphs 77 to 82) to the range of matters that a Court may consider (proposed section 139F) to protect valid interests and avoid undue hardship in relation to a s 139D or 139E application for an order. Nonetheless, further consideration must be given to strengthening the Court's discretionary powers in these matters particular where the challenged arrangement is highly remote from the event of bankruptcy.

50. A further avenue by which either inadvertent or unreasonable exposure of innocent parties interests might be partially protected would be to develop some flexibility around the concept of non-divisible property. Whilst the draft Bill in ss 139AJ(2), 139AL(2) and 139AM(3) recognises the interrelationship with s 116(2) in so doing protecting such property, discretion might be allowed to expand on an individual bankruptcy basis the range and quantum of property protected, particularly where the relation-back is substantially before the event of bankruptcy.

5.3 Various consequences leading to significant financial impact

51. Stemming also from proposed ss 139D and 139E discussed above, the interaction of these sections particularly with proposed s 139AL (dealing with supply of personal services) and proposed s 139AM (anti-avoidance), potentially give rise to a range of consequence which challenges the statement made in the Readers' Guide to the Explanatory Memorandum that the Bill will have no significant financial impact.

52. At a practical level, with such extensive and potentially ad hoc review of past transactions and structuring arrangements crossing between an individual's business and personal affairs without time limit, relevant records and documents are likely to be unavailable to properly deal with these matters which have extended back beyond the reasonable record retention requirements of both taxation and corporations legislation. The increased cost and delay in litigation caused will likely be further compounded by the need stemming

[15] Ibid.

[16] *Commonwealth of Australia v Western Mining Corporation* (1996) Fed No. 229/96 per Black CJ at para 60.

from the application of provisions, such as those contained in s 139AM(1)(e)[17], to trace changing ownership, reconcile joint or multiple ownership and determine appropriate market value. The issues become all the more complex where the business structures being challenged, though otherwise valid, involve commercial profits/losses, capital injections and distributions.

53. It is unclear whether consideration has been given to the interaction of these extensive powers of vesting and sale with capital gains tax. For instance proposed s 139AL which prima facie is intended to either "look through" or set aside, amongst other structures, service trusts[18] to supply and charge support and overhead services to professional partnerships, along with the wide definitions of "entity"[19], "scheme"[20] and "disposal of property"[21], potentially generates events that should reasonably be expected to attract exemption from CGT.

54. The proposed changes to the Bankruptcy Laws may have a cost impact on practitioners, as it is envisaged that there would be a need to arrange an increase in the limit of indemnity under the firm's Professional Indemnity policy with consequential increased premiums. It is envisaged that such increased overhead costs would ultimately be passed on to the client.

55. It is noted that in various states, limitation of liability schemes are in place and others are in draft form before Parliament. Once in place, these schemes will have the effect of limiting the liability of members under the Scheme (and therefore confining the indemnity limit to a set statutory limit). There are major issues relative to the capping regime however, which are as follows:

- the legislative process has been very slow at a state level;
- such schemes will not be effective unless the Trade Practices Act is amended to address loopholes in the Commonwealth legislation which currently undermines the integrity of the states' professional standards legislation.

[17] Dealing with use, transfer and replacement of property

[18] It is noted that the use of such arrangements can and are challenged by the ATO under ITAA 36 Pt IVA where there is a dominant tax purpose and services are charged at non-arm's length rates.

[19] s 5(1)

[20] s 139AAA

[21] s 139AB

6. Concluding remarks

56. The Bill has been introduced to address situations where high income earners have used bankruptcy to avoid tax and other known obligations, while retaining use of their personal assets. CPA Australia is supportive of the intent of the proposed amendments, however considers there are more appropriate avenues through which to pursue such behaviour.

57. The retrospective aspect of the Bill will create uncertainty in business dealings, and create a significant burden of proof for SMEs as the time frame of the Bill exceeds current requirements for keeping business records.

58. The Bill will create further divergence in the treatment of personal and corporate bankruptcy, in particular in the time zones for treating the recovery of assets. This divergence will increase the complexity of regulation for small businesses.

59. Introduction of the Bill as it stands will have a significant financial impact on small businesses as they will be assumed to be guilty of attempting to defraud creditors and will carry the burden of proof. The lack of consistency with existing record keeping requirements will further increase their costs. In addition, new businesses will have no option but to incorporate, adding significant costs and regulatory complexity to the business start-up process.

60. The Bill will undoubtedly impact on business investment and confidence. The concept of limited liability granted to corporations, is designed to encourage investment, promote reasonable commercial risk taking and the accumulation of wealth. However, not all businesses can incorporate so those who can't, use legitimate business structures such as trusts to limit their liabilities and to manage their personal risks. The flow-on effect will impact on the economy and job creation.

61. The time frame for consultation on this significant piece of legislation has been extremely short. Many businesses likely to be impacted are not yet aware of the likely impact. However feedback from CPA Australia members demonstrate a growing concern in the business community, not just amongst professionals, of the consequences of this Bill.

62. CPA Australia has provided a number of recommendations for consideration by the Committee. It is essential that the Committee review the proposed amendments carefully and look to narrowing the Bill to more effectively address its objectives rather than introduce broad ranging measures that will impact on the whole business community.

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