AUSTRALIAN BANKERS' ASSOCIATION

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Ms Gillian Gould
Committee Secretary
House of Representatives Standing Committee on
Legal and Constitutional Affairs
Parliament House
CANBERRA ACT 2600

Dear Ms Gould

RE: BANKRUPTCY LEGISLATION AMENDMENT (ANTI-AVOIDANCE AND OTHER MEASURES) BILL 2004 (draft Bill)

The Australian Bankers' Association (ABA) is pleased to have the opportunity to express its views to the Committee on the draft Bill.

The ABA represents 23 banks authorized to carry on the business of banking in Australia and is represented on the Attorney-General's Bankruptcy Reform Consultative Forum.

General Comment

The draft Bill contains proposed changes to bankruptcy laws in the draft Bill that arise out of the Joint Task Force Report on the use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax (JTR). The JTR arose out a series of reports that a small but significant number of high income professionals were using bankruptcy to avoid the payment of tax. These professional people had the ability to pay their tax but chose to fund a lifestyle and build up assets in the names of third parties with the ultimate purpose of avoiding payment of tax.

In at least one ensuing court case the Australian Tax Office (ATO) was criticised for failing to have acted promptly to address the failure of one professional to lodge tax

returns for some 17 years. This raises the question whether legislative intervention is necessary if tax enforcement and recovery procedures are working effectively.

Membership of the Joint Taskforce did not include representation from the private sector and in particular the finance sector. The JTR does not take account of financing other than to observe that the private sector (which would include financiers) is able to assess the credit worthiness of debtors before a decision is made to advance or allow credit to them. The JTR suggests that the ATO cannot choose its tax debtors or secure itself against a debtor's assets. Priority for tax debts was abolished years ago.

The ABA supports the Government in its endeavours to stamp out deliberate practices designed solely to avoid payment of tax. The ABA's concern is that the draft Bill extends beyond such arrangements for the avoidance of payment of tax to potentially affect certain third party rights and interests.

For third parties such as banks and other lenders the new proposals could increase credit risk and possibly create uncertainty in lending decisions.

Lenders grant credit to individuals on the basis that they have the cash flow or income to repay.

The proposals in the draft Bill could alter the basis of a lender's credit risk because a court would be able to unwind arrangements entered into by a bankrupt with a related entity. The lender dealing with the related entity may not know of these arrangements in advance or be able to ascertain them from the financial position of the related entity disclosed at the time credit is approved. The related entity could therefore have a diminished position as a result of an associate's bankruptcy.

It is submitted that this requires that a lender's interests are protected in respect of the assets of the debtor entity against which it has lent.

It is submitted that this makes it important that a lender's interests are protected where it is not possible in all cases for the lender to secure itself against the assets of the debtor entity.

Recovery of assets using family law type division of property principles.

The proposals in the draft Bill in effect elevate unsecured creditors of a bankrupt to a status equivalent to that of a married partner enjoying the benefits of rules for the division property that were designed for the well being of families and children of families following a breakdown of marriage.

The property division rules under family law would be applied irrespective of the knowledge of a third party of the main purpose of the bankrupt in arranging how assets are acquired and held. The bankrupt's trustee need only allege the existence of a "tainted purpose" of the bankrupt in transferring assets and the evidential burden shifts to the respondent or third party to displace the trustee's allegation. It is submitted that this shift of the evidential burden places an arms length creditor of the non-bankrupt entity at a disadvantage.

The draft Bill contains no requirement that the trustee must have reasonable grounds for making an allegation of the existence of a "tainted purpose" in respect of property.

Also, under family law, a court must have regard to all the property of the married parties and may alter the interests of the parties to the marriage according to a range of principles that include a party's contribution to the acquisition or maintenance of an asset, a party's own financial needs and circumstances and justice and equity. The draft Bill does not explicitly provide for the court to fully apply these family law principles and to take account of counterveiling transfers of property that the bankrupt spouse might be required to make if the there was a family law proceeding on foot.

Under bankruptcy law, the proposals would enable a court to examine only those assets that were acquired wholly or substantially by a related entity of the bankrupt with the income or resources of the bankrupt that otherwise would not be available to the trustee. It is unclear what would be the position of a non-bankrupt spouse in this scenario. It could be that the non-bankrupt spouse takes nothing from the marriage other than what he or she brought to the marriage or acquired solely during the course of the marriage. Any other property would be accessible by the trustee.

For creditors, this could mean that the trustee would obtain a priority as regards property to which creditors of the non-bankrupt spouse would otherwise have recourse.

Whilst the ATO's risk of not recovering any unpaid tax from the bankrupt's estate would be lessened, the risk of loss to creditors of the non-bankrupt spouse would increase.

The position of the non-bankrupt spouse could be worsened further if that spouse were operating a business. If a lender had lent money to the spouse for the acquisition of business assets and the bankrupt had paid amounts in reduction of the loan the spouse could face loss of the business through the confiscation of the spouse's reputed ownership of those assets by the bankrupt's trustee if the bankrupt had derived a benefit from those assets.

The draft Bill is not limited to married partners. The draft Bill's provisions would extend to others who have a non-arms length relationship with a bankrupt including parents, children, siblings and others.

The small business could be seriously disadvantaged if business assets are transferred to a company structure by a sole trader as part of tax planning and equity participation considerations and this is subsequently challenged by the trustee.

The provisions of the draft Bill also potentially strike at common family trust arrangements where property is settled in trust and utilised to provide income support for family members.

Priority of Security Interests

The draft Bill raises issues of priority of security interests leading to increased credit risk for lenders.

If as a result of the application of the provisions in the draft Bill the bankrupt is found to "own" part or the whole of property secured by mortgage in favour of a lender, it is unclear whether the protection for secured creditors of a bankrupt under section 58 of the Bankruptcy Act applies in those circumstances. Section 58 provides for the vesting of property of the bankrupt in the bankrupt's trustee. Sub-section 58 (5) provides "Nothing in this section affects the right of a secured creditor to realize or otherwise deal with his or her security".

While the draft Bill empowers the court to make a vesting order in respect to tainted property it is not clear whether the effect of a vesting order means that the property vests in the trustee within the meaning of section 58 so that sub-section 58(5) can apply.

Also, if debts are incurred by the bankrupt to the bank and secured over tainted property of the spouse under third party security arrangements (typically a guarantee and mortgage) would the security extend to the whole of the tainted property? If the debts are of both spouses, either jointly or severally, would the court undertake an investigation and apportion them according to the parties' re-defined interests in the property or would the secured creditor be entitled to treat the debts as originally incurred without regard to the parties' altered interests as declared?

If a bank is under a continuing funding obligation to the non-bankrupt entity and the bank receives notice of the bankruptcy of the owner's spouse or partner or a caveat is lodged by the trustee, what then are the bank's obligations? It has a contractual obligation to make further advances to the non-bankrupt person within the scope of the relevant security but it may lose priority or the security itself for these later advances.

The ABA understands that the policy underlying the draft Bill is not to disturb secured creditors' rights with respect to property and to the enforcement of their security interests. The ABA respectfully requests the Committee to ensure that the draft Bill places these security rights beyond contention.

Supervised Account Regime

In principle, the ABA agrees with the proposed supervised account regime provided application of the provisions in the draft Bill do not place an additional administrative, risk or regulatory burden upon banks that provide a "supervised account" requested by a bankrupt's trustee.

The ABA considers that the proposed regime should not impose obligations upon all authorised deposit taking institutions (ADIs) to develop and make available particular deposit products or to "police" the operation of the bankrupt's supervised account. Otherwise, the ABA would be opposed to the regime.

However, the draft Bill contemplates that a supervised account opened by a bankrupt under notice from the trustee must be opened with an ADI and the account must be specially designed to prevent it becoming overdrawn. The bankrupt would be required to tell the ADI that the account is a supervised account.

It does not appear to be the intention that ADIs would be required to design and make available supervised account products. Rather, where an ADI does make a supervised account available the account must conform to the requirements specified in the trustee's notice under clause 139ZIE of the draft Bill and "such other requirements (if any) as are specified in the notice" (clause 139ZIE (1) (a) (ix)). The ABA submits that liability for ensuring that the supervised account is a conforming account should rest with the bankrupt and not the ADI.

The ABA is concerned that the draft Bill should make this clear:-

- Clause 139ZIE provides that the bankrupt must open a supervised account on receipt of notice from the trustee and carry out certain other specified acts. Although these requirements are expressed to be imposed on the bankrupt, clause 139ZIE (6) (and other similar clauses in the draft Bill) provides that

  "a person is guilty of offence if:
  (a) the person is subject to a requirement under subsection (3) or (5); and
  (b) the person engages in conduct; and
  (c) the person's conduct breaches the requirement."

It is not clear from the reference to "a person" rather than to "the bankrupt" whether the proposed provision is confined to conduct by the bankrupt or could extend to conduct by third parties. The concern is that if an ADI innocently or inadvertently provides a supervised account that is not in conformity with the trustee's notice the ADI might be subject to the penalty provision.

The ABA submits that it should be made clear that the requirements imposed on the bankrupt under clause 139ZIE are limited to the bankrupt. The ABA recommends that the words "a person" are replaced with "the bankrupt" in clause 139 ZIE. For the same reasons clauses 139ZIEA (6), 139ZIF (4), 139ZIG (7), 139 ZIH (9), 139ZIHA (9) and 139 ZII (7) should be amended accordingly.

The ABA mentions some additional specific concerns:-

- Clause 139ZIG provides for the trustee's supervision of withdrawals from the supervised account. In particular, a bankrupt must not make a withdrawal from the account without the consent of the trustee. In circumstances where a bankrupt seeks to make a withdrawal from the supervised account with the consent of the trustee, the legislation should specifically exempt the ADI from notice or being put on inquiry as to the existence or otherwise of the trustees' consent for the withdrawal.

- Under sub-clause 139ZIG (2) (i), a withdrawal from an account is permitted for payment of *"a fee or charge in connection with the operation of the account"*. For the avoidance of doubt, the ABA recommends that this phrase should be amended to include a reference to a fee or charge made by the ADI for the holding and closure of the supervised account so that account keeping fees (as distinct from transaction fees) and costs associated with the closure of the account may be recovered by the ADI.

- There could be additional potential accounting and reporting tasks for ADIs arising from the operation of a supervised account. It is submitted that a bank should not be put to monitoring or reporting requirements such as collecting and collating data about the operation of the account over and above the normal statement of account services that banks customarily provide to their customers.

The ABA trusts that its comments on the draft Bill are of assistance to the Committee.

Yours faithfully,