



PARLIAMENT OF AUSTRALIA

## House of Representatives Standing Committee on Legal and Constitutional Affairs

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### Background

The amendments proposed by the draft Bill are intended to address the issue of high income professionals using bankruptcy as a means 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.

The amendments have been developed following a Joint Taskforce Report on the Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax. The Taskforce consisted of officers from the Attorney-General's Department, Insolvency and Trustee Service Australia, the Australian Taxation Office and Treasury.

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 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.

The Taskforce made a number of recommendations for amendments to relevant Commonwealth legislation and administrative practices. The amendments proposed in this draft Bill will implement a number of the Report's key recommendations relating to the *Bankruptcy Act 1966* and the *Family Law Act 1975*.

### Proposed Amendments

The draft Bill proposes to replace the existing Division 4A of Part VI of the Act with a new Division which will improve the ability of trustees to recover property held by third parties where:

- the property was acquired by that third party using funds or property provided by the bankrupt
- the bankrupt's purpose in making that transfer was to ensure that the funds or property would not be available to pay creditors, and

- the bankrupt has used or derived a benefit from the property now held by the third party (including any replacement property which can be traced to the original transfer).

The provisions will not apply where the third party provided market value consideration in return for the original transfer and the transfer occurred more than 10 years prior to the bankruptcy. Nor will they apply where the third party provided market value consideration in return for the original transfer and, where the transfer occurred less than 10 years prior to the bankruptcy, the transferee was unaware of the bankrupt's purpose in making the transfer.

Arrangements of the type which are potentially within the scope of the new provisions are not uncommon. Many professional people consider such arrangements to be a legitimate way of arranging their affairs to protect some of their personal wealth from claims which arise as a result of their professional activities. For professionals who are required to practise in their own name (that is, who are not allowed to incorporate), there arrangements may be seen as providing protection comparable to that given to a corporation.

The amendments proposed by this Bill represent a fundamental shift away from the perceived legitimacy of these arrangements. Although the arrangements may continue to be legitimate for other purposes, the Government does not believe that these assets should remain protected where creditors' claims cannot be met from assets held in the bankrupt's name whilst the bankrupt continues to enjoy a lifestyle effectively funded by his or her own means. The bankruptcy system should not be the means by which a person can protect his or her wealth from business failure whilst creditors bear all the risk associated with that failure.

#### *Interaction between family law and bankruptcy*

There are a number of difficulties which can arise when bankruptcy and family law issues or proceedings exist at the same time. There are inconsistencies between family law and bankruptcy which create uncertainty for all involved and can cause hardship for either or both of the creditors and non-bankrupt spouse.

From a bankruptcy perspective, trustees can find themselves in an uncertain position when having to resolve or reconcile competing claims. Creditors unaware of the potential property interest of a non-bankrupt spouse also suffer from a lack of certainty.

From a family law perspective, the legal ownership of property does not always reflect the non-financial contribution of the parties to the marriage. The special interest of the non-bankrupt spouse in the marital property created through both financial and non-financial contributions, which may be recognised by the Family Court in exercising its discretion to alter property interests, is not expressly recognised under the Act.

Different outcomes presently arise depending upon the order in which events occur (those events including separation, bankruptcy and distribution of property by the trustee in bankruptcy).

The amendments proposed in this Bill will address these issues by clarifying the rights of the bankruptcy trustee and the non-bankrupt spouse. Generally, the amendments will enable concurrent bankruptcy and family law proceedings to be brought together to ensure all the issues are dealt with at the same time.

#### *Collection of income contributions*

Where a bankrupt is employed and has been assessed as liable to pay contributions from his or her income, the Official Receiver can issue a notice to the employer garnisheeing the bankrupt's wages to collect the amount assessed. The Official Receiver can also issue a garnishee notice to a bank or other financial institution to collect contributions.

Some bankrupts (including some high-income professionals) are not 'employed' as such and do not operate bank accounts in their own names. The existing contribution collection scheme is not effective in these cases where the bankrupt chooses not to comply.

These deficiencies will be addressed by the supervised account regime to be introduced by this draft Bill. The amendments will allow the trustee to have access to all of the bankrupt's income before it reaches the bankrupt. This will enable the trustee to use the existing methods for collecting income contributions by ensuring that the bankrupt operates a bank account (into which all income must be deposited) under the trustee's supervision.

#### *Family law agreements*

The draft Bill also proposes amendments to ensure that a bankrupt cannot use financial agreements under Part VIIIA of the Family Law Act to defeat the claims of creditors. One amendment will exclude financial agreements from the definition of 'maintenance agreement' to ensure that trustees can use the Act's 'clawback' provisions to recover property transferred prior to bankruptcy pursuant to such an agreement. A further amendment will introduce a new act of bankruptcy which will occur when a person is rendered insolvent as a result of assets being transferred under a financial agreement – this will mean that the person's bankruptcy will be taken to have commenced at the time of that transfer which will extend the 'relation back' period. This will allow the trustee to claim property transferred under the agreement as divisible property in the bankrupt's estate.