

Overview of the Proposed Bill

- 2.1 This chapter sets out the main elements of the proposed Bill, with respect to:
- recovery of property;
 - interaction between family law and bankruptcy;
 - collection of income contributions; and
 - family law agreements.

Recovery of Property

- 2.2 The draft Bill proposes to replace the existing Division 4A of Part VI of the Act with a new Division which will allow trustees in bankruptcy to recover property held by third parties/entities where:
- the property was acquired by a third party/entity 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).
- 2.1 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 bankruptcy, the transferee was unaware of the bankrupt's purpose in making the transfer. However a reverse onus of proof applies.

2.2 The Explanatory Memorandum describes the policy underlying these proposed changes:

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. 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).¹

2.3 The Explanatory Memorandum also notes that, while they may impact on arrangements commonly used by professionals and business people, the proposed changes represent a 'shift' in Government policy:

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), these 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

1 BLAAAMB 2004 Explanatory Memorandum, p.3.

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.²

- 2.4 It has been stated that such individuals should rely on insurance for protection. Evidence given shows this is not a viable option.
- 2.5 The proposed amendments can result in the shifting of risk from creditors to the family of the debtor which is effected by elevating the status of the creditor to the same level or better than the family of the debtor. This highlights competing public policies between the aim of the *Family Law Act 1975* to look after children, and that of bankruptcy law which is to look after the interests of creditors. These aims are in conflict in the exposure draft.

Interaction between Family Law and Bankruptcy

- 2.6 The Bill also contains amendments dealing with the interaction between family law and bankruptcy. The Explanatory Memorandum refers to the 'difficulties' that can arise when bankruptcy and family law proceedings exist at the same time:

There are inconsistencies between family law and bankruptcy law 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.

2 BLAAAMB 2004 Explanatory Memorandum, p. 4.

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).³

- 2.7 The Bill proposes to clarify the rights of the trustee in bankruptcy and the non bankruptcy spouse in these circumstances by, generally, enabling concurrent bankruptcy and family law proceedings to be brought together (see Chapter 4).

Supervised Account Regime

- 2.8 The Bill proposes to introduce a supplementary income collection regime (a 'supervised account regime') which will allow the bankruptcy trustee, in certain circumstances, to have access to all the bankrupt's income before it reaches the bankrupt.
- 2.9 The Explanatory Memorandum describes the perceived inadequacies of the current income collections regime and the general intent of the proposed change:

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

3 BLAAAMB 2004 Explanatory Memorandum, p.4.

a bank account (into which all income must be deposited)
under the trustee's supervision.⁴

Family Law Agreements

- 2.10 The draft Bill also proposes amendments dealing with the use of financial agreements under Part VIIIA of the Family Law Act prior to bankruptcy. One amendment will exclude binding financial agreements from the definition of "maintenance agreement" to allow the trustee to use the Act's "clawback" provisions to recover property transferred prior to bankruptcy pursuant to such an agreement.
- 2.11 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.
- 2.12 The committee noted that prior to amendments in 2000 all financial agreements had to be sanctioned by the Court. This requirement was removed in 2000.
- 2.13 The Committee is of the view, however, that financial agreements should revert to the pre-2000 amendments to the *Family Law Act 1975*.

Recommendation 1

- 2.14 **The Committee recommends that financial agreements revert to the pre-2000 amendments to the *Family Law Act 1975* and be subject to confirmation by the court which shall take into account bankruptcy ramifications.**

4 BLAAAMB 2004 Explanatory Memorandum, pp. 4-5.