

Supervised Account Regime

Outline of Chapter

- 5.1 In this chapter of the report the following issues are considered:
- Support for the proposed change.
 - Criticism of the proposed change, namely that it:
 - ⇒ could have unintended consequences for bankrupts;
 - ⇒ fails to fully address the trustee's obligations in relation to the operation of the proposed supervised account regime; and
 - ⇒ may impose an additional burden on the bank where the relevant supervised account is held.
 - The Committee's conclusion and recommendation.

Background

- 5.2 The current income contributions scheme requires bankrupts earning over a threshold to contribute towards their bankruptcy a proportion of their income exceeding the threshold.¹ Generally, the assessed contribution is garnisheed from wages paid to employed bankrupts

¹ The income contributions scheme is contained in Division 4B of Part VI of the Act. The current threshold is \$35 271.60 (after-tax amount) for a contributor without dependants. The threshold increases for each dependant.

or from accounts held by them with a financial institution.² There are provisions in the current scheme to allow review and adjustment in circumstances including 'hardship'.³

5.3 As noted in Chapter 1, the amendments proposed in Schedule 3 of the draft Bill are intended to overcome the perceived deficiencies in the current income contributions scheme. These proposed deficiencies are made apparent where the bankrupt is not 'employed' or does not operate a bank account in his or her own name.⁴ In those circumstances, the existing garnishee powers in the Act may prove ineffective.⁵

5.4 Under the proposed change, the trustee will in certain cases have access to all of the bankrupt's income before it reaches the bankrupt. The trustee will be able to require the bankrupt to pay all of their income into a bank account that is supervised by the trustee.⁶ The existing garnishee powers in the Act would then be used by the trustee to draw the assessed contribution from the supervised account.⁷ The trustee must not make a determination that the supervised account regime applies to the bankrupt unless the bankrupt has been assessed as liable to pay a contribution and has either not paid the whole of an instalment at the time it became payable, or has not paid the whole of a contribution at the time it became payable.⁸

5.5 The proposed change also provides for agreement to be reached between the trustee and the bankrupt on certain matters. These include the amount and frequency of withdrawals from the account to meet the bankrupt's living expenses (while ensuring that the balance of the account remains sufficient to meet the bankrupt's liability for contributions) and consent by the trustee to additional withdrawals to meet unexpected liabilities or where a balance has accumulated in the

2 The garnishee powers are contained in Subdivision 1 of Division 4B of Part VI of the Act.

3 A bankrupt may apply to the trustee for a determination of a higher income threshold on the basis of 'hardship' (section 139T). A decision of the trustee to make an assessment is reviewable in the first instance by the Inspector-General in Bankruptcy (section 139ZA). An application may be made to the Administrative Appeals Tribunal for review of the relevant decision of the Inspector-General (section 139ZF).

4 BLAAAMB 2004 Explanatory Memorandum, p.5.

5 BLAAAMB 2004 Explanatory Memorandum, p.5.

6 Proposed section 139ZIF, BLAAAM 2004.

7 Proposed subsection 139ZIG(8).

8 Proposed subsection 139ZIC(2).

account that exceeds the amount required to meet the bankrupt's contribution amount.⁹

- 5.6 Decisions made by the bankruptcy trustee will be reviewable in the first instance by the Inspector-General in Bankruptcy,¹⁰ and then by the Administrative Appeals Tribunal.¹¹
- 5.7 The proposed Schedule 3 imposes criminal sanctions for contravention of certain provisions. These offence provisions will apply where the bankrupt breaches requirements including compliance with a 'supervised account notice' (requiring a bankrupt to open a supervised account);¹² provision of certain information to the trustee about the relevant account;¹³ and the requirement to make only authorised withdrawals from the account.¹⁴

Support for the Proposed Change

- 5.8 There was some qualified support for the proposed change. The ABA agreed with the proposed supervised account regime provided that its application did not 'place an additional administrative, risk or regulatory burden upon banks that provide a "supervised account" requested by a bankrupt's trustee'.¹⁵ The IRC of the LCA also expressed qualified support for the proposal, stating that:

In so far as the proposals are only intended to operate where the bankrupt has defaulted in his or her obligations, the LCA lends cautious support to them but recommends the application of the provisions be monitored for any unintended or overly harsh consequences.¹⁶

9 Proposed subsection 139ZIG(3).

10 Proposed section 139ZIO.

11 Proposed section 139ZIT.

12 Proposed subsection 139ZIE(6).

13 Proposed subsection 139ZIE(6).

14 Proposed subsection 139ZIG(7).

15 ABA, *Submission 113*, p.5.

16 The IRC of the LCA, *Submission 98*, p.34.

Criticism of the Proposed Change

- 5.9 The following criticisms were raised in relation to this proposal:
- that the proposed change could have unintended consequences for bankrupts;
 - that the proposed change fails to fully address the trustee's obligations in relation to the proposed supervised account regime; and
 - that clarification of certain elements of the proposed change is required to ensure that it does not impact unnecessarily on the bank where the relevant supervised account is held.

Unintended Consequences

- 5.10 The IRC of the LCA suggested that the proposed change could result in unintended consequences for bankrupts who do not receive cash funds for the provision of services:¹⁷

A bankrupt may choose, rather than working and paying contributions, to cease working and take over the child care responsibilities of the non bankrupt spouse. The bankrupt is liable then to be assessed for the non-financial benefits he receives, but also, potentially, for the work he or she undertakes as primary care giver to the children of the relationship. If the trustee were to make an assessment and require the opening of a relevant account, the receipt of any funds by the bankrupt from the non-bankrupt spouse potentially have to be paid to that account notwithstanding they are for the benefit of the family at large. Given the criminal sanctions attached to any failure to comply with the direction of the trustee to pay money to an account, there is concern as to how these provisions may operate in practice.¹⁸

17 Note that current section 139Y of the Act provides that the trustee may regard a bankrupt in certain circumstances as receiving reasonable remuneration in respect of employment, work or activities.

18 The ICA of the LCA, *Submission 98*, p.35.

The Trustee's Obligations under the Proposed Change

- 5.11 The IPAA expressed concern that the proposed regime failed to provide sufficient certainty in relation to the trustee's obligations. One of these concerns related to the trustee's obligations in relation to tax liabilities:

The bankrupt may well have structured his or her business activities in a "tax affective manner" but the Trustee may not be comfortable with the legality of these arrangements from a Tax Law perspective. Accordingly, if the Trustee administers the Supervised Account in a less tax effective way than that previously conducted by the bankrupt, could the trustee be personally (and/or the Estate) be held liable for the "extra" payments that will have to be made to the ATO? In these circumstances it would be prudent for a Bankruptcy Trustee to obtain expert tax advice. Who will be liable to pay for this extra impost- the Trustee? the Estate? or through the Estate, the creditors?¹⁹

- 5.12 A further concern of the IPAA was in relation to the review process set out in proposed Schedule 3:

What happens in the circumstance where the bankrupt takes steps to appeal the Trustee's underlying Income Contributions Assessment? If the Income Contributions Assessment is subject to an appeal, will this prevent a Trustee from determining that the Regime will apply to the bankrupt? Section 139ZIC is silent on this issue. It would be preferable if the Trustee could apply the Regime whilst the underlying Income Contribution Assessment is being reviewed under appeal from the bankrupt. Otherwise a bankrupt may use this mechanism to frustrate the Regime.²⁰

Clarification in Relation to ADIs

- 5.13 The ABA raised concerns in relation to the potential impact of the suggested change on ADIs.²¹ In this regard, the ABA submitted that:

19 IPAA, *Submission 69*, p.10.

20 IPAA, *Submission 69*, p.10.

21 An 'ADI' is an 'authorised deposit-taking institution' - section 5 of the Act defines this term for the purposes of the Act.

- the proposed legislation should make clear that liability for ensuring that the supervised account is a conforming account should rest with the bankrupt and not the ADI;²²
- the proposed legislation should exempt the ADI from notice or being put on inquiry as to the existence or otherwise of the trustee's consent for withdrawal from the supervised account by the bankrupt;²³
- for the avoidance of doubt, the proposed legislation should make clear that an authorised withdrawal is one which is made for a fee or charge imposed by the ADI for the holding and closure of the supervised account;²⁴ and
- banks should not be put to monitoring or reporting requirements in relation to the supervised account beyond the normal statement of account services that banks customarily provide to their customers.²⁵

Other Issues

- 5.14 A further concern raised by the IPAA was that, as it failed to provide for an overdraft facility, the proposed supervised account regime would create problems for 'seasonal businesses':

The Act does not allow for a Trustee to utilise an overdraft facility with respect to the Supervised Accounts Regime. This will pose considerable difficulty in seasonal businesses, particularly where the Regime is commenced during a low cashflow period and where there are extremely good prospects, subject to the bankruptcy being funded in the meantime, of obtaining large cashflow surpluses at a future date. Accordingly, in our opinion, the utilisation of an overdraft account should be left to the discretion of the Trustee.²⁶

- 5.15 The IRC of the LCA suggested that the threshold levels in the current income contributions scheme be reviewed. This submitter referred to
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22 ABA, *Submission 113*, p.5- in this regard, the ABA recommended amendments to proposed sections 139ZIE, 139ZIEA, 139ZIF, 139ZIG, 139ZIH, 139ZIHA and 139ZII.

23 ABA, *Submission 113*, p.6.

24 ABA, *Submission 113*, p.6.

25 ABA, *Submission 113*, p.6.

26 IPAA, *Submission 69*, p.10.

‘anecdotal evidence’ suggesting that even nominal contributions by the bankrupt may cause hardship to families. In the view of the IRC of the LCA therefore, ‘considerations should be given to reviewing the threshold levels to ensure that they properly reflect a standard (of) living which will not otherwise cause undue hardship to innocent third parties’.²⁷

Conclusion

- 5.16 The Committee recognises however that there are potential enforcement problems with the current income contributions scheme and recommends that the proposed amendments be implemented.

Recommendation 5

- 5.17 **The Committee recommends that the amendments proposed in Schedule 3 of the draft Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 be implemented.**

²⁷ The IRC of the LCA, *Submission 98*, p.35.