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Recovery of Property Amendments: Proposed New Division 4A of Part VI of the Bankruptcy Act

Outline of Chapter

3.1 In this chapter of the report the following issues are considered:

- Support for the proposed change.
- Criticism of the proposed change, namely that it-
  - ⇒ is a disproportionate response;
  - ⇒ will unfairly impact on asset protection arrangements;
  - ⇒ is retrospective;
  - ⇒ places an onerous burden on asset owners by reversing the onus of proof; and
  - ⇒ is unconstitutional.
- Suggested alternatives to the proposed change, including to-
  - ⇒ make no change to the current Act;
  - ⇒ strengthen the existing claw back provisions in the Act, in particular s120 and s121 of the existing Act; and
  - ⇒ specifically target tax avoiders who become bankrupt.
- The Committee's concerns in relation to the proposed change.
- The Committee's conclusion and recommendations.

Background

3.2 Current Division 4A of Part VI was introduced into the Act by virtue of the *Bankruptcy Legislation Amendment Act 1987*. The provision allows the trustee to obtain property in certain circumstances from an 'entity' that was 'controlled' by the bankrupt and benefited from his or her 'personal services'. The purpose of the provision is to allow the trustee to recover a bankrupt's property in the situation where that property is disguised as an asset of a trust, company or the like.[1]

3.1 The Bill proposes to substitute this Division with a new Division 4A of Part VI. Central to the proposed amendments are the concepts of a 'tainted purpose', 'tainted property' and 'tainted money'. The 'Simplified Outline' in section 139AA of the Bill describes the key features of the proposed new Division:

> This Division enables the Court to make an order for the recovery of the whole or a part of tainted property, or tainted money, held by an entity other than the bankrupt.
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> Tainted property is:
>
> (a) property wholly or partly funded by money paid to the entity by the bankrupt before the date of the bankruptcy, where the bankrupt had a tainted purpose in paying the money and the bankrupt used or derived a benefit from the property; or
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> (b) property transferred to the entity by the bankrupt before the date of the bankruptcy, where the bankrupt had a tainted purpose in transferring the property, the transfer was not made for full value and the bankrupt used or derived a benefit from the property; or
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> (c) property or money held by the entity as a result of personal services supplied by the bankrupt to or for or on behalf of the entity, where the bankrupt did not receive arm's length remuneration for those services and (in the case of property) the bankrupt used or derived a benefit from the property; or
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> (d) property or money held by the entity as a result of a scheme entered into or carried out for a tainted purpose, where (in the case of property) the property was not acquired for full value and the bankrupt used or derived a benefit from the property.

1 Bankruptcy Legislation Amendment Bill 1987 Explanatory Memorandum, p.114.

Tainted money is:

(a) money paid to the entity by the bankrupt before the date of the bankruptcy, where the bankrupt had a tainted purpose in paying the money; or

(b) money that represents the proceeds of the disposal of tainted property.

Each of the following is a tainted purpose:

(a) to prevent the property or money from becoming divisible among the bankrupt's creditors; or

(b) to hinder or delay the process of making the property or money available for division among the bankrupt's creditors.

In considering whether to make an order for the recovery of the whole or a part of tainted property or tainted money, the Court must have regard to various matters, including:

(a) the contribution (whether financial or non-financial) of the bankrupt and the entity; and

(b) in the case of property— the extent to which the bankrupt used or derived a benefit from the property.

Support for the Recovery of Property Amendments

3.2 Only three submissions, including the submission from ITSA, expressed support for the proposed new Division 4A of Part VI. However, a recurring theme in submissions was support for the intent underlying the proposal. The following comments were typical:

> AFCCRA strongly supports the Attorney's intention in this Bill to address the issue of high income professionals using bankruptcy to avoid taxation and other obligations. We believe that any abuse or perceived abuse of bankruptcy brings it into disrepute and makes its appropriate use as a last resort for indebted Australians more difficult.[2]

> AICD strongly supports the stated policy objectives of the Bill set out in the Explanatory Memorandum, namely, to, address the issue of high income professionals using bankruptcy as a means of avoiding their taxation and other obligations. AICD also supports solutions aimed at addressing the identified

2 AFCCRA, *Submission 86*, p.1.

> '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.[3]
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> IWIRC supports the objects of the BLAB, particularly with respect to "people who have deliberately and knowingly set about to avoid being able to contribute to their legal obligations using bankruptcy and putting their assets beyond the reach of creditors".[4]

Criticisms of the Recovery of Property Amendments

3.3 While the evidence suggested a significant degree of support for its policy objectives, the overwhelming number of submissions were critical of the proposed new Division 4A of Part VI. Criticism of the proposed amendment took a number of forms:

- that the proposal is a disproportionate response to the concerns of the ATO as a creditor;
- that the proposal will have unintended consequences for individuals who have legitimately structured their affairs to protect family assets;
- that the retrospective effect of the proposal is a 'draconian' consequence;
- that placing the onus of proof on the respondent entity will create an unfair and onerous burden; and
- that the proposal is potentially unconstitutional.

A Disproportionate Response

3.4 A number of submissions raised as an issue that the proposed change was a 'disproportionate response' and a 'blanket solution' to address the particular concerns of the ATO. In its submission, the Insolvency and Reconstruction Committee (IRC) of the Law Council of Australia (LCA) asked the question 'Are high income professionals causing a

3 AICD, *Submission 54*, p.1.

4 IWIRC, *Submission 80*, pp.1-2.

"Black Hole" in ATO revenue through bankruptcy?' and provided the following comments:

> It is submitted that the loss of tax revenue, as a percentage of all claims provable in a bankruptcy does not warrant the wholesale changes being proposed…The reforms are not being introduced because of any widespread community concern but because of the concerns of a minority stakeholder.[5]

3.5 Comments in a similar vein included:

> Any attempt by the Government to reform the bankruptcy laws in a general way to specifically aid the ATO to recover tax debts must properly take into account the implications blanket reform would have on small and large businesses, corporate activity and the Australian economy.[6]

> The Bill is an overreaction to the perceived inability of one creditor, the Australian Taxation Office ("ATO"), to undertake effective recovery action against tax evaders or recalcitrant debtors. Instead of dealing with the ATO's problem with targeted, specific legislation or by exploring existing mechanisms, a blanket solution has been proposed with indiscriminate effect and apparently without due consideration being given to the ramification of such a solution.[7]

Impact on Asset Protection Arrangements

3.6 The overwhelming majority of submissions contended that, as its provisions would allow the trustee to recover assets that had never been owned by the bankrupt, or that had been transferred by the bankrupt many years previously, the proposal would undermine the ability of professionals and business people to protect assets for the benefit of family members:

> Many people structure their affairs to protect their assets for the benefit of their family against the wrongdoing of others. These are people who operate in partnership and therefore are jointly and severally liable for their partner's activities. If

5 The IRC of the LCA, *Submission 98,* p. 17.

6 Arnold Bloch Leibler, *Submission 97,* p.3.

7 Professions Australia, *Submission 81,* pp. 1-2.

> their partner is held to be negligent they will also be liable even though they have not been personally negligent or even knew of their partner's negligent activities. In order to protect their family assets against claims the assets are often not held in the individual's name.
>
> It is no argument to say these people can achieve the same result by operating through a company because in many instances they are legally required to operate in partnership and not in a company. The fact that the Bill operates retrospectively, with no retrospective time limit, significantly compounds the issue.[8]

3.7 A number of organisations gave examples to demonstrate the potential impact of the proposed changes on small business generally:

> Suppose you have a hypothetical situation of a career public servant who might have worked for 30 years. The public servant built up a reasonable nest egg and decided to resign and start off a small business. In that circumstance it is quite reasonable or quite prudent for the wife, for instance, to own the assets, whereas the husband might go off and enter into the business venture which may be of some risk. In those circumstances, the wife can never be properly protected in terms of the husband's future business venture if these amendments were to come through unaltered.[9]

3.8 A related issue raised in submissions was the perceived necessity of asset protection arrangements given the inability of many professionals to adequately insure against risk:

> The AMA strongly believes that individuals and businesses should carry appropriate insurances, however, it is simply not possible to insure against all potential risks. World-wide problems for the insurance industry have seen the rationalisation of policies and small businesses and professionals have found it extremely difficult to access affordable insurance cover for some activities.[10]
>
> Insurance is not always available, and even if it is, there is no guarantee it will cover the risks encountered or be available.

8 National Tax & Accountants' Association Ltd, *Submission 83,* p.1.

9 Pitcher Partners, *Transcript of Evidence , 5 July 2004,* pp.66-67.

10 AMA, *Submission 77,* p.6.

> There is also the issue of HIH Insurance that failed not so long ago and left people with exposures.[11]

3.9 A further issue raised by submitters was that, as a result of their impact on legitimate asset protection arrangements, the proposed changes would adversely impact on risk taking and entrepreneurial activity:

> Professionals and business people who take risks are likely to reduce their exposure to risk and this will have a direct impact on people wanting to go into business and employ people. This will have a direct impact on employment and GDP over time.[12]

3.10 This criticism of the proposed new Divisions 4A of Part VI was also raised by groups other than business and profession organisations. The potential impact of the proposed new Division 4A of Part VI on arrangements designed to protect assets from the consequences of a gambling addiction was raised as an issue by AFCCRA:

> We do see a small number of clients where there may be a gambling problem, for instance, where there is property. The family home may be put into the name of the non-gambling spouse as a means of protecting it and also as a means of confirming that, in fact, the gambler has used their share of the family property, so to speak, in their gambling activity. That could be impacted by some of the provisions of this Bill, and that is a concern to us.[13]

3.11 A related concern was that the proposed change was directed at 'high income professionals' but would potentially impact on individuals generally:

> In Master Builders view, the Bill would also have significant impact on the existing financial arrangements of small businesses, not just the "high income professionals" against which its provisions are directed and which are singled out in the Taskforce Report…There is no specific targeting of

11 *Submissions 7, 9, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 55, 57, 75, 76, 89, 90, 91, 92, 93, 94, 115.*

12 *Submissions 7, 9, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 55, 57, 75, 76, 89, 90, 91, 92, 93, 94, 115.*

13 AFCCRA, *Transcript of Evidence, 6 July 2004,* p.34.

> recalcitrant high income groups that have successfully used and abused the system in the past and hence the Bill's provisions affect widely used methods of separating family and private assets from business related personal liability.[14]
>
> There is nothing in the Bill to prevent its application to middle-income, or even low-income Australians…If the true intention is to restrict the operation of the Bill to "high income professionals" then a statement to that effect should be included in the Bill itself.[15]

Retrospectivity

3.12 The proposed new Division 4A of Part VI will have retrospective effect.[16] This retrospectivity was the subject of much of the criticism of the proposed change. A recurring theme in submissions was that the proposal was unjust in that it would allow the trustee in bankruptcy to challenge transactions that were legitimate at the time they were entered into:

> ACEA believes that the retrospective nature of the proposed additional powers of the trustee is contrary to reasonable expectations by firms of certainty, particularly when the practice has been viewed as legitimate and is not motivated by fraudulent or dishonest purposes.[17]
>
> The proposed legislation is retrospective in the sense that it potentially alters the future consequences of past events. This effectively leads to a situation where a person undertakes a completely lawful transaction one day and the next has sanctions attached to that action. It is this type of retrospective law about which the most reservations are generally expressed.[18]

3.13 Conversely, some submitters focused on the potential difficulties that trustees in bankruptcy may face as a result of the retrospective nature of the proposed amendments. The IPAA referred to the 'unintended consequences' of this aspect of the proposed change:

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14 Master Builders Australia, *Submission 58,* p.2.

15 Wesley Community Legal Service, *Submission 87,* p. 1.

16 BLAAAMB 2004, Schedule 1, Item 5.

17 ACEA, *Submission 88,* p.6.

18 Professions Australia, *Submission 81,* p. 28.

> At the time of commencement there could be estates where the Trustee has paid the final dividend to creditors but the estate is still current. Will this Trustee be obliged to now investigate the bankrupt's affairs in relation to the amendments? Will the Trustee be required to fund this investigation him or herself? If the Trustee does not conduct such an investigation, will the Trustee be negligent?
>
> Will the Trustee be required to investigate every current bankruptcy to determine if the amendments apply to that estate? Who will fund the cost of the exercise?[19]

3.14 In a similar vein Howarth Melbourne stated that 'very simply the paper trail is seldom readily available' and that, because the relation back period proposed by the draft Bill exceeds statutory requirements for record keeping, the trustee will be provided with 'unworkable legislation'.[20]

3.15 A further concern raised in relation to the retrospective nature of this proposal was its potential implications for lending practices. The Australian Bankers' Association stated that:

> The concern for the bank, in lending to the small business, is that what it sees in terms of the business's statement of assets and liabilities may be illusory. There may be out there waiting to happen an event which will cause a divestiture of those assets, and that is a very serious concern. Would banks have to inquire into the background of every business that comes along to make an application for finance?[21]

3.16 The potential for the proposed change to impact on lending practices was also raised as an issue by Professions Australia.[22]

Reverse Onus of Proof

3.17 The Bill provides that, if the trustee alleges that the bankrupt had a 'tainted purpose' in the transfer of property or payment of money, it will be presumed that this is the case. It will then be up to the respondent entity (and the bankrupt if he or she is joined as a party

19 IPAA, *Submission 69,* p.5.

20 Howarth Melbourne, *Submission 74,* p.29.

21 Mr Gilbert, *Transcript of Evidence,* 5 July 2004, p. 82.

22 Professions Australia, *Submission 81,* p.42.

under proposed section 139CA) to rebut this presumption with evidence to the contrary. The Explanatory Memorandum notes the following in relation to this reverse onus of proof:

> This provision must be considered in the context of the proposed new Division 4A. The new Division is intended to address the problem of high income professionals divesting themselves of wealth prior to bankruptcy while continuing to derive a benefit from that wealth. As noted in paragraph 16, while asset protection arrangements are not uncommon, the Government considers that they should not continue to provide protection when an individual becomes bankrupt. Creditors will be denied access to the bankrupt' s real or substantive wealth where a bankrupt has arranged his or her affairs such that very few assets are 'owned'. In presuming that the bankrupt undertook certain transactions prior to bankruptcy with a 'tainted purpose' , the new scheme reflects the Government' s commitment to challenge the legitimacy of asset protection upon bankruptcy.[23]

3.18 A large number of submissions criticised this feature of the proposed changes, claiming that it would place an onerous burden on the respondent entity and the bankrupt. Of particular concern to submitters was the potential difficulty in providing the necessary evidence where the relevant transfer of property had occurred many years previous. Mr Suryan Robert Chandrasegaran noted that, where the property had been transferred a number of decades ago and records of the transfer were not available, it would be 'almost impossible for such an entity to prove its case'.[24] Cleary Hoare Solicitors suggested that the asset owner would have 'extreme difficulty' in locating evidence as to the purpose of a transfer occurring many years before.[25]

3.19 The monetary and emotional cost of rebutting the presumption of a 'tainted purpose' was also raised as an issue by submitters. Cleary Hoare Solicitors stated that 'Even if the asset owner wins, he or she will be put to significant cost and pain over a long period. There are two major costs of litigation: one is dollars and the other is a very

23 BLAAAMB 2004 Explanatory Memorandum, p.11.

24 Mr Suryan Robert Chandrasegaran, *Submission 116,* p. 2.

25 Cleary Hoare Solicitors, *Transcript of Evidence,* 6 July 2004, p.47.

heavy load of negative energy'.[26] AFCCRA noted that 'access to legal resources' in order to rebut the presumption in favour of a 'tainted purpose' may prove difficult for the respondent entity.[27] The Family Law Section of the Law Council of Australia had similar concerns, stating that:

> If the respondent entity is a mother in a family where the principal income earner is insolvent the cost of defending proceedings by the bankruptcy is likely to be catastrophic. The reversal of the onus of proving a tainted intention or purpose will have devastating consequences in the Family Law context.[28]

3.20 A related concern raised was that, in the context of a family breakdown, the non bankrupt spouse or partner may be hindered in his or her efforts to rebut the presumption by a hostile or disinterested bankrupt. The National Network of Women's Legal Services stated that 'the problem is, if the parties have separated, the bankrupt spouse may have no interest in assisting the non-bankrupt spouse to protect their share of the property cake…It would be difficult to obtain the evidence required and an uncooperative former spouse may be able to actively thwart the non-bankrupt's case.'[29] This concern was also raised by the Family Law Section (FLS) of the LCA:

> A recalcitrant bankrupt may not wish to rebut the tainted purpose argument and may in fact make allegations supporting such purpose in order to get even with their spouse or other entity (like a business partner).[30]

Constitutional Issues

3.21 It was suggested by some submitters that certain features of this proposal may be unconstitutional. These concerns were twofold- that the proposal may not be a law 'with respect to bankruptcy' (refer s51xvii of the Commonwealth Constitution) and that the proposal constituted an acquisition of property not on just terms (refer s51xxxi of the Commonwealth Constitution). Mr Terry Dwyer stated that:

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26 Cleary Hoare Solicitors, *Transcript of Evidence,* 6 July 2004, p.47.

27 AFCCRA, *Submission 86,* p.2.

28 The FLS of the LCA, *Submission 98,* p. 3.

29 National Network of Women's Legal Services, *Submission 108,* p. 7.

30 The FLS of the LCA, *Submission 98,* p. 4.

> There seems to be some logical difficulty in asserting that a *solvent* person cannot do as he wishes with his money or property. A law founded on the opposite assumption is hardly a law with respect to bankruptcy. It seems rather a law for the unjust acquisition of property- to seize A's property to pay B's debts, for example, seems to be a Constitutionally questionable legislative adventure. [31]

3.22 A further issue raised in this respect was in relation to the reverse onus of proof. Professions Australia suggested that reversing the onus of proof may be unconstitutional as 'A provision such as that creating the Presumption arguably weakens and impairs the supremacy of the law in the administration of justice and constitutes a legislative usurpation of judicial power'.[32]

Alternatives to Proposed new Division 4A of Part VI

3.23 There were many suggested alternatives to this proposed change. Suggestions included:

- leaving the Act 'as is'- the rationale being that the current claw back provisions in the Act were adequate to achieve the policy objectives of the proposed change;
- strengthening the existing claw back provisions in the Act- namely ss120 and 121; and
- amendments to the Act and / or tax legislation to specifically target individuals who use bankruptcy to avoid paying a tax debt they can otherwise afford to pay.

No Changes to Current Provisions

3.24 It was the contention of some submitters that the current provisions in the Act are adequate to meet the policy objectives of this proposed amendment- namely, to address the problem of high-income earners using bankruptcy to avoid paying debts that they can afford to pay. McCullough Robertson Lawyers stated that 'The existing provisions in the Bankruptcy Act are largely adequate to meet community

31 Mr Terry Dwyer, *Submission 73,* p.1.

32 Professions Australia, *Submission 81,* p. 36.

needs'.[33] The Queensland Law Society also suggested that the current provisions in the Act were sufficient, stating that the proposal was based on an 'erroneous belief' in relation to the usage of the existing Division 4A of Part VI:

> Such provisions have in fact been used on previous occasions. There may have only been a couple of reported decisions of the courts on section 139D and 139E, but the lack of reported case law does not truly reflect the number of occasions that registered trustees in bankruptcy have referred to these particular provisions of the Act and settled claims based on those sections.[34]

3.25 Other submitters contended that 'the case for change' had not been sufficiently made out. The National Farmer's Federation stated that 'It has not been shown that existing bankruptcy and taxation powers are inadequate to deal with the specific cases raised over deliberate bankruptcy to avoid debts'.[35] The LCA also raised this as an issue.[36]

Strengthen the Existing Claw Back provisions

3.26 An alternative suggested by a number of submitters was to strengthen the existing claw back provisions in the Act. Section 120 of the Act deals with transfers for less than market value consideration while section 121 deals with transfers to defeat creditors:

> **Section 120 of the Bankruptcy Act**
>
> **(Undervalued transactions)**
>
> *Transfers that are void against trustee*
>
> (1) A transfer of property by a person who later becomes a bankrupt (the *transferor*) to another person (the *transferee*) is void against the trustee in the transferor's bankruptcy if:
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> (a) the transfer took place in the period beginning 5 years before the commencement of the bankruptcy and ending on the date of the bankruptcy; and
> (b) the transferee gave no consideration for the transfer or gave consideration of less value than the market value of the

33 McCullough Robertson Lawyers, *Submission 61,* p. 3.

34 Queensland Law Society, *Submission 64,* p. 2.

35 National Farmer's Federation, *Submission 109,* p. 1.

36 The IRC of the LCA, *Submission 98,* p. 4.

property.

Exemptions

(2) Subsection (1) does not apply to:

(a) a payment of tax payable under a law of the Commonwealth or of a State or Territory; or
(b) a transfer to meet all or part of a liability under a maintenance agreement or a maintenance order; or
(c) a transfer of property under a debt agreement; or
(d) a transfer of property if the transfer is of a kind described in the regulations.

Transfers that are not void

(3) Despite subsection (1), a transfer is not void against the trustee if:

(a) the transfer took place more than 2 years before the commencement of the bankruptcy; and
(b) the transferee proves that, at the time of the transfer, the transferor was solvent.

Refund of consideration

(4) The trustee must pay to the transferee an amount equal to the value of any consideration that the transferee gave for a transfer that is void against the trustee.

What is not consideration

(5) For the purposes of subsections (1) and (4), the following have no value as consideration:

(a) the fact that the transferee is related to the transferor;
(b) if the transferee is the spouse or de facto spouse of the transferor—the transferee making a deed in favour of the transferor;
(c) the transferee's promise to marry, or to become the de facto spouse of, the transferor;
(d) the transferee's love or affection for the transferor.

Protection of successors in title

(6) This section does not affect the rights of a person who acquired property from the transferee in good faith and by giving consideration that was at least as valuable as the market value of the property.

Meaning of transfer of property and market value

(7) For the purposes of this section:

(a) *transfer of property* includes a payment of money; and
(b) a person who does something that results in another person becoming the owner of property that did not previously exist is taken to have transferred the property to the other person; and
(c) the *market value* of property transferred is its market value at the time of the transfer.

Section 121 of the Bankruptcy Act

(Transfers to defeat creditors)

Transfers that are void

(1) A transfer of property by a person who later becomes a bankrupt (the *transferor*) to another person (the *transferee*) is void against the trustee in the transferor's bankruptcy if:

(a) the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred; and
(b) the transferor's main purpose in making the transfer was:
(i) to prevent the transferred property from becoming divisible among the transferor's creditors; or
(ii) to hinder or delay the process of making property available for division among the transferor's creditors.

Showing the transferor's main purpose in making a transfer

(2) The transferor's main purpose in making the transfer is taken to be the purpose described in paragraph (1)(b) if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent.

Other ways of showing the transferor's main purpose in making a transfer

(3) Subsection (2) does not limit the ways of establishing the transferor's main purpose in making a transfer.

Transfer not void if transferee acted in good faith

(4) Despite subsection (1), a transfer of property is not void

against the trustee if:

(a) the consideration that the transferee gave for the transfer was at least as valuable as the market value of the property; and

(b) the transferee did not know that the transferor's main purpose in making the transfer was the purpose described in paragraph (1)(b); and

(c) the transferee could not reasonably have inferred that, at the time of the transfer, the transferor was, or was about to become, insolvent.

Refund of consideration

(5) The trustee must pay to the transferee an amount equal to the value of any consideration that the transferee gave for a transfer that is void against the trustee.

What is not consideration

(6) For the purposes of subsections (4) and (5), the following have no value as consideration:

(a) the fact that the transferee is related to the transferor;

(b) if the transferee is the spouse or de facto spouse of the transferor—the transferee making a deed in favour of the transferor;

(c) the transferee's promise to marry, or to become the de facto spouse of, the transferor;

(d) the transferee's love or affection for the transferor.

Exemption of transfers of property under debt agreements

(7) This section does not apply to a transfer of property under a debt agreement.

Protection of successors in title

(8) This section does not affect the rights of a person who acquired property from the transferee in good faith and for at least the market value of the property.

Meaning of transfer of property and market value

(9) For the purposes of this section:

(a) *transfer or property* includes a payment of money; and

(b) a person who does something that results in another person becoming the owner of property that did not

previously exist is taken to have transferred the property to the other person; and
(c) the *market value* of property transferred is its market value at the time of the transfer.

3.27 The comments and suggestions made by the LCA in relation to strengthening these provisions included:

> The principle objection taken by the LCA to Schedule 1 of the BLAAAM is that it seeks to vest third party property in the trustee for the benefit of creditors when the usual connection to bankruptcy (being insolvency and intention to defeat creditors) is not otherwise apparent.
>
> As the Cummins case[37] showed there isn't necessarily anything wrong with the existing bankruptcy laws. The primary issue a trustee will confront is one of proof: how does the trustee prove the bankrupt's intention at a time long past when documents may be long destroyed?
>
> These problems can be acceptably addressed without damaging the integrity of our bankruptcy laws by amending the existing section 120 and 121 to add a number of rebuttable presumptions. In particular:
>
> - Where the debtor fails to lodge a tax return in circumstances where the debtor was obliged to do so and otherwise had a tax liability for that period it can be presumed, for the purpose of section 120 and 121 (subject to the respondent proving otherwise), that the bankrupt was insolvent at (or within a period about) that time.
> - Where the debtor was obliged to do so by law but fails to keep or preserve proper books and records it can be presumed for the purpose of section 120 and 121 (subject to the respondent proving otherwise) that the bankrupt was insolvent at (or within a period about) that time. Such provision would need to reconcile with the bankrupt's obligations to retain books and records (see for example s 270 of the Act).[38]

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37 *Prentice v Cummins (No 5)* [2002] FCA 1503- the bankrupt had been a QC since 1980, and had not filed a tax return since 1955 (45 years). The ATO was the largest creditor in the bankrupt estate. The trustee commenced proceedings under section 121 of the Act. The court found that a transfer by the bankrupt of his interest in the family home to his wife had been made with the intention to defeat the interests of the ATO as creditor.

38 The IRC of the LCA, *Submission 98,* p.29.

3.28 Pitcher Partners suggested an alternative similar to that proposed by the LCA, stating that, as much of the existing concern related to the practical difficulties associated with the operation of section 121, an option was the create a 'presumption of insolvency' for the purposes of section 121 in circumstances where 'a transfer of property or diversion of income occurred at a time when there was non compliance with various income tax requirements, such as the lodgement of an income tax return, or the payment of an income tax concession'.[39] The IWIRC on the other hand suggested amending section 121 to enhance the trustee's recovery of property powers where 'the bankrupt is either receiving a "benefit" or is in a "position of influence" with respect to the third party and that property'.[40] The optioning of strengthening the current claw back provisions as an alternative to the proposed change was also referred to by a number of witnesses in the public hearings.[41]

A 'tax problem' Requires Tax-specific Remedies

3.29 A further alternative suggested was to amend the Act and relevant tax legislation to specifically target those who go bankrupt to avoid paying tax debts. Central to this line of reasoning is that, as the Taskforce Report was motivated by the actions of professionals who became bankrupt to avoid paying tax debts that they could afford to pay, any changes should be directly aimed at addressing that particular problem. Moore Stephens HF suggested amending income tax legislation enabling the assessment raised to persons who have received the benefit of the income determined by similar tracing provisions to that proposed but restricted to know taxation liabilities at the time of bankruptcy.[42] The ICAA stated that the operation and fairness of the bankruptcy system should not be changed to facilitate the collection efforts of the ATO and that:

> This should be dealt with by the Income Tax Assessment Act or the ATO adopting more proactive and timely procedures to ensure that high earning fee-for-service professionals are

39 Pitcher Partners, *Submission 102,* p.18.

40 IWIRC, *Submission 80,* p.2.

41 IPAA, *Transcript of Evidence*, 5 July 2004, p.41; AFCCRA, *Transcript of Evidence,* 6 July 2004, p.37; AICD, *Transcript of Evidence,* 6 July 2004, p.67.

42 Moore Stephen HF, *Submission 32,* p.15.

> lodging their tax returns and paying their tax obligations on time.[43]

The ICAA further proposed that, should people fail to discharge their tax obligations and proceed into bankruptcy then:

> …the existing claw back provisions under s139A of the Bankruptcy Act (should) be amended to provide for the period of claw back which currently prevails to be extended by one year for every year that a tax obligation is outstanding. Alternatively, the proposed amendments of the Bill should only apply when it could be clearly demonstrated by the trustee that the acquisition of property acquired by the third party using funds or property provided by the bankrupt was designed to avoid the payment of a tax liability.[44]

3.30 Professions Australia suggested that the objectives of the Bill could be achieved by means such as increasing the resources of the ATO so that it may effectively pursue tax avoiders; increasing the efficiency of ATO debt collection procedures; and increasing the collection and cross referencing of information available to the ATO.[45]

3.31 The NIA similarly suggested that the resources of the ATO should be increased to aid its debt collection activities.[46]

Other Suggested Alternatives

3.32 CPA Australia suggested that a hierarchy of recoveries was appropriate. This would involve firstly, ensuring that the Income Tax Assessment Act and the Tax Administration Act collection and recovery regimes have been fully pursued, secondly, that the existing mechanisms provided in the Act which make property available for the payment of debts are applied in the first instance and, finally, facilitating resort to the appropriately modified extensive powers envisaged in the draft Bill.[47] The modifications to the draft Bill suggested by CPA Australia included redrafting section 139AFB (dealing with exempt full value transfers of property) to more closely

43 ICAA, *Submission 68,* p.3.

44 ICAA, *Submission 68,* p.3.

45 Professions Australia, *Submission 81,* p.43.

46 NIA, *Submission 114,* p.5.

47 CPA Australia, *Submission 82.1* , p.1.

parallel the scope and operation of current section 123;[48] including a requirement that the trustee must show that the various recovery arrangements currently contained in Part IV Division 3 have been reasonably exhausted in the list of factors for the court to take into account in section 139F of the draft Bill;[49] and developing some flexibility around the concept of non-divisible property in the draft Bill by introducing a discretion to expand on that concept on an individual bankruptcy basis.[50]

3.33 An alternative suggested by Pitcher Partners was to introduce a special act of bankruptcy which would occur where specified taxation obligations, such as the lodgement of an income tax return or the non-payment of tax, is not complied with.[51]

Other Issues

3.34 An issue arising out of the public hearings was that the proposed change may contain a potential loophole. The provisions allow the trustee to recover money or property from an entity where that money or property has been paid or transferred by the bankrupt. This raises the question of whether it would be relatively easy for an entity to defeat the scheme by effecting a second transfer of the relevant property.

3.35 There is a general anti-avoidance provision in the draft Bill. Section 139AM would allow the trustee to recover property from subsequent transferees where that property had been acquired as part of a 'scheme' designed to defeat the interest's of the bankrupt's creditors. ITSA explained that, in order to satisfy this provision, the trustee would have to demonstrate that a second transfer 'was effectively one transfer and just went through a number of entities'.[52]

3.36 Nonetheless, it was acknowledged by ITSA that the proposed new scheme could 'potentially' be defeated by a second transfer of the property.[53] This was notwithstanding that 'if the person who

48 CPA Australia, *Submission 82.1,* p.3.
49 CPA Australia, *Submission 82.1,* p.1.
50 CPA Australia, *Submission 82.1,* p.13.
51 Pitcher Partners, *Submission 102,* p.17.
52 ITSA, *Transcript of Evidence,* 6 July 2004, p.16.
53 ITSA, *Transcript of Evidence,* 6 July 2004, p.16.

originally received the property was to sell it then the proceeds of the sale of any replacement property could be recovered by the trustee but only from the entity that received the original transfer'.[54]

The Committee's Concerns

3.37 The Committee's primary concern in relation to this proposal is its potential to impact on arrangements designed to protect assets for the benefit of family members. The retrospective nature of this proposal would allow the trustee to recover property that had been transferred by the bankrupt (or had been acquired with funds provided by the bankrupt) many years prior to the bankruptcy. Where there was no hint or expectation of insolvency, the proposal will deem that these transfers or payments were made with a 'tainted purpose' and the onus to prove otherwise rests with the respondent entity. The proposed change does not require a link between the transfer and the debtor's solvency at the time the transfer was undertaken - this is in contrast to the current claw back provision dealing with transfers to defeat creditors (section 121).[55] It is the Committee's view therefore that the net effect of this proposal is to quarantine creditors from risk and to transfer that risk to the family of the bankrupt.[56]

3.38 Some technical aspects of the proposal are also of concern to the Committee. Section 139F of the draft Bill lists factors that the court has to take into account when determining whether to make an order under the Division. Included in these factors are terms such as 'hardship', 'use' and 'benefit'. These terms are not defined in the draft Bill. In the Committee's view, this lack of clarity would create uncertainty in the application of the proposed provisions.[57]

3.39 There is also the problem of the use of these provisions in the context of a family breakdown. As noted above, a number of submitters raised as an issue that the non bankrupt spouse or partner may be hindered in his or her efforts to rebut the presumption by a hostile or

54 ITSA, *Transcript of Evidence,* 6 July 2004, p.17.

55 Refer section 121(2) of the Act.

56 *Transcript of Evidence,* 6 July 2004, p.39.

57 *Transcript of Evidence,* 5 July 2004, p.27.

disinterested bankrupt. The Committee perceives this a valid concern in relation to the proposal.[58]

3.40 A further concern of the Committee is in relation to the efforts of the ATO to address the problem that motivated this legislative proposal. The Committee is not satisfied that the ATO has put adequate systems in place to ensure that professionals can fail to lodge tax returns for an excessive number of years, and then become bankrupt to avoid that very debt. One of the recommendations of the Taskforce Report was that subsection 16(4) of the Income Tax Assessment Act and section 3C of the Taxation Administration Act be amended to authorise the Commissioner of Taxation to provide publicly available information to prescribed industry or professional organisations. This proposal has not been implemented. It is the Committee's view that such amendments would go some way to addressing the problems identified in the Taskforce Report.

3.41 In any event, the problem of the ATO's failure to ensure the tax compliance of high earning professionals, in one case for 45 years, has largely been overcome. The combination of the GST, ABN and BAS requirements means that such individuals are easily tracked.[59]

3.42 It was the view of the Committee that the weight of evidence supports the Committee's recommendation that the amendments proposed in Schedule 1 of the draft Bill should be abandoned.

3.43 The Committee notes that the current claw back provisions in the Act were used in the *Prentice v Cummins*[60] decision to recover assets transferred by the bankrupt with the intention to defeat the ATO as creditor. However, that decision is the subject of an appeal. An option suggested by a number of submitters, and in particular the LCA, was to strengthen the current claw back provisions in the Act to address the specific problem which motivated these changes- that of high income earners using the bankruptcy system to avoid paying tax debts that they could afford to pay. In the view of the Committee, this would seem preferable to the blanket and exceedingly disproportionate proposed changes.

58 *Transcript of Evidence,* 6 July 2004, pp.6-8.

59 *Transcript of Evidence,* 22 July 2004, p.15.

60 *Prentice v Cummins (No 5)* [2002] FCA 1503.

Conclusion

3.44 The Committee has concluded that there is no justification established for a legislative amendment which would effectively quarantine creditors from risk and place that risk on to the family of the debtor. Nor has a case been established to render illegitimate transfers that had been undertaken years ago. As noted by a number of submitters, it is entirely reasonable for business people and others to want to divest themselves of certain assets to provide for the future wellbeing of their families should adverse circumstances arise.[61] Moreover, the Committee notes evidence from ITSA that the amendments proposed in Schedule 1 would be unlikely to improve a trustee's ability to recover any additional assets in a Bond or Skase type situation.[62] However, it is also the view of the Committee that there is some case for strengthening the current provisions to specifically deal with the problems identified in the Taskforce Report.

3.45 The Committee also concludes that reforms to tax legislation should be introduced to allow the ATO to provide bankruptcy and related information to professional bodies. This would provide a significant disincentive for professionals to use bankruptcy to avoid their taxation obligations. This information could include information that identifies individuals who have been bankrupt, subject to a Part IX or Part X arrangement under the Bankruptcy Act, or convicted of a tax offence. Such an amendment would reduce costs for professional associations, and would compliment the disciplinary measures that these bodies may undertake.

Recommendation 2

3.46 **The Committee recommends that:**

- **the amendments contained in Schedule 1 of the draft Bankruptcy Legislation Amendment (Anti-Avoidance and other Measures) Bill 2004 be abandoned; and**

61 See for example, *Transcript of Evidence*, 6 July 2004, p.63.

62 ITSA, *Transcript of Evidence*, 22 July 2004, p.8.

- **Insolvency and Trustee Service Australia and the Attorney-General's Department undertake fresh consultation with the Bankruptcy Reform Consultative Forum with a view to strengthening the current clawback provisions in the Act (sections 120 and 121 in particular).**

Recommendation 3

3.47 **The Committee recommends that subsection 16(4) of the *Income Tax Assessment Act 1936* and section 3C of the *Taxation Administration Act 1953* be amended to:**

- **authorise the Commissioner of Taxation to provide publicly available information to prescribed industry or professional organisations; and**
- **authorise the Commissioner of Taxation to utilise publicly available information for the purposes of the role of Chief Executive of the Australian Tax Office.**