COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS

Reference: Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004

MONDAY, 5 JULY 2004

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS

Monday, 5 July 2004

Members: Mrs Bronwyn Bishop *(Chair)*, Mr Murphy *(Deputy Chair)*, Mr Cadman, Mr Kerr, Mr McClelland, Ms Panopoulos, Mr Sciacca, Mr Secker, Mr Somlyay and Dr Washer

Members in attendance: Mrs Bronwyn Bishop, Mr Murphy, Mr Secker and Dr Washer

Terms of reference for the inquiry:

To inquire into and report on:

The provisions of the draft Bill. Specifically, the Committee will consider whether these provisions adequately address the problems identified in the Taskforce Report, namely:

(a) high income earners using bankruptcy to avoid paying debts that they can afford to pay, while continuing to enjoy a lifestyle made possible through the build up of assets in the names of the third parties

(b) the uncertainty arising from the interaction between family law and bankruptcy

(c) the inadequacy of the current income contributions scheme in circumstances where a bankrupt chooses not to comply, and

(d) the use of financial agreements to defeat the claims of creditors

WITNESSES

Committee met at 9.04 a.m.

CHAIR—I declare open this public hearing of the House of Representatives Standing Committee on Legal and Constitutional Affairs inquiry into the exposure draft of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004. The proposed changes to the bankruptcy law contained in the draft bill are based on the recommendations contained in the joint task force report on the use of bankruptcy and family law schemes to avoid the payment of tax. The task force was established to consider whether any changes should be made to bankruptcy and taxation laws to ensure bankruptcy is not used as a means to avoid tax obligations.

The committee has been asked to examine whether the draft bill addresses the problems identified in the task force report—namely: (a) high-income earners using bankruptcy to avoid paying debts that they can afford to pay while continuing to enjoy a lifestyle made possible through the build-up of assets in the names of third parties; (b) the uncertainty surrounding the interaction between bankruptcy and family law; (c) the inadequacy of the current income contributions scheme when the bankrupt chooses not to comply; and (d) the use of financial agreements to defeat the claims of creditors. The committee has received more than 120 submissions in relation to this inquiry, and the majority of these raise serious concerns with the draft bill. During the next two days we will be hearing from a wide range of people, including the Australian Taxation Office, the Law Council, CPA Australia, the AMA and the Australian Bankers Association.

[9.09 a.m.]

FARR, Mr Gregory Douglas, Second Commissioner of Taxation, Australian Taxation Office

LIND, Ms Judith Helen, Assistant Commissioner, Serious Noncompliance, Australian Taxation Office

YONG, Mrs Megan Elizabeth, Assistant Commissioner, Operations, Australian Taxation Office

CHAIR—Welcome. Thank you for coming this morning. I read out in my opening remarks the reason why this legislation has been drafted. I think we are all familiar with the stories that came out of Sydney, particularly out of the Sydney bar, where barristers had never paid tax, never filed a tax return—in one case, for as long as 45 years—and had used the bankruptcy provisions to avoid paying any tax. I have to ask this question right at the beginning: what on earth was the Taxation Office doing that it did not know these people were not paying any tax?

Mr Farr—The tax office were concerned about the nonpayment of tax, and the use of the bankruptcy and family law acts to avoid payment of tax, by certain members of the New South Wales bar from about the mid- to late 1990s. In fact, we had begun to have discussions with the Bar Association as early as 1997, so we had been concerned about that for some period. At that time we were taking action to recover the amounts of money that were payable, but I guess we were coming across some frustration at certain members who were using the bankruptcy and family law provisions to simply avoid paying tax. Certainly some had not lodged income tax returns, but they were fairly few in number—from memory, about three. The major mischief that we were concerned about was that, for those who were lodging returns, they were living what appeared to be a very good lifestyle. In some cases they were accumulating significant assets. But when we actually took the recovery matter through to bankruptcy, the trustee appeared to be unable to recover from the estate of the bankrupt any significant dividends.

It was not until the commissioner raised in a speech, I think in September 1999, the prospect that he would name these people in his annual report that we really started to get some traction and some interest from the profession and some ability to deal with the matters. Subsequent to that, changes to state legislation and to the discovery requirements have meant that we have been able to address a large number of those issues in that particular industry. It was not that we were not aware of it; we were in fact dealing with it. Yes, there were some who had not lodged returns, but they were fairly small in number. Through the trustees and their relevant bankrupt estates, we simply were unable to recover the money.

CHAIR—But this was going on for 45 years and we did nothing about it until the mid-1990s. What happened before that?

Mr Farr—There are a number of things that I would say there. In only isolated cases did this happen for some period of time. Really we are talking about one case largely that goes back for that period of time.

CHAIR—That is the Cummins case?

Mr Farr—It was, yes.

CHAIR—And you were successful in applying to the court—or the trustee was—and having the half interest in the matrimonial home retrieved from the third entity, who was the wife, which had been transferred some 13 years previously. Doesn't that show that the law works?

Mr Farr—In that particular case, we were successful in the first instance. I understand that that matter is currently on appeal. But for each one of those cases where we were successful—such as the Cummins case—there are a whole range of others where the trustee has been unable to recover any dividends on behalf of the Commonwealth.

CHAIR—Give me an example of one such case that you lost.

Mr Farr—It is not a case that we have lost; it is the case that the trustee in that case has received no dividend from any—

CHAIR—No, give me an example of a case that the trustee lost. This is under section 121, if my memory serves me correctly, isn't it?

Mr Farr—Yes. We are a bit concerned about section 16. I am not sure about naming individual cases in this matter.

CHAIR—I think in this hearing we are perfectly happy for you to go right ahead and name them. It is privileged information here.

Mr Farr—Could we proceed without actually naming it but giving the facts of the particular case? We still are concerned; it is not normal before these committees, as I understand it, to actually name the taxpayers.

CHAIR—You just told me that in 1999 the commissioner said he was going to name these people who had been doing bad things. Has he?

Mr Farr—No, he has not.

CHAIR—Why didn't he?

Mr Farr—There were doubts about the legality of whether he could in the end. I think that was one of the main reasons he did not in the end.

CHAIR—Because of the Privacy Act?

Mr Farr—That is correct.

CHAIR—Do we all have a problem with the Privacy Act?

Mr Farr—I do not think it is a problem with the Privacy Act. As you are aware, the exposure draft of the bill deals with certain matters of the secrecy provisions and our ability to provide—

CHAIR—If the case has actually gone to court, we do not have a problem in naming the case because it is already on the public record.

Mr Farr—Yes.

CHAIR—So give me the name of a case that the trustee in bankruptcy took to court and lost.

Mr Farr—I am not aware of the name of a particular case that has gone to court, but I can take it on notice if you like. Certainly in these cases we have sought legal advice, the trustees in those cases have sought legal advice, and the advice is that we would simply be unsuccessful. So, rather than take that matter on, where we have—

CHAIR—But you have already got a precedent with the Cummins case, so why wouldn't you take other actions? Or why would the trustee—I will have to ask him that, I guess. You presumably do not drive the cases. You just seek a dividend. Is that right?

Mr Farr—Our role is to provide information to the trustee and to assist the trustee recovering the dividend on our behalf, yes.

CHAIR—As matter of interest, didn't the commissioner publish the names of tax defaulters a long time ago?

Mr Farr—Many years ago that was the case. I know this was very much on his mind at that time and obviously he raised it publicly in a speech. At the end of the day, the advice I think he got was that he was on very delicate legal ground to be able to do that.

CHAIR—I appreciate that, but shaming tax defaulters can be a very effective mechanism. All of this legislation, as I understand it, is supposed to be directed at high income earners who are socially prominent and living well and, believe me, to be named adversely would be a very good deterrent. So why don't we have a recommendation to change the Privacy Act to allow the commissioner to name them?

Mr Farr—I think the recommendation that is contained in the exposure draft of the bill is to allow us to provide information to professional associations.

CHAIR—It is not what I had in mind.

Mr Farr—No, I understand that, but that is the direction that the recommendations were coming from.

CHAIR—I take it you would not mind if you had the power to publish those names?

Mr Farr—As you say, in the appropriate circumstances it would be a significant deterrent. Of course, we would have to be very careful about the circumstances in which we used that.

CHAIR—There is a second thing that I am quite intrigued by. One of the people who defaulted and became public was employed by the tax office itself as a consultant—and he still did not pay any tax. I find that quite curious. Having knowledge of their lifestyle and the fact that they have not paid tax, why don't you use the betterment tax provisions?

Mr Farr—Do you mean doing an asset betterment?

CHAIR—Yes.

Mr Farr—I think we do that in those circumstances. We also need to keep it in perspective. When we were looking at barristers, in the end I think there were around 62 of them. They were obviously very high profile and they obviously caused significant concerns around the integrity of the tax system. It became a major issue for us.

CHAIR—In how many of the cases of those 62 barristers did you use the betterment tax provisions?

Mr Farr—We would only use asset betterment where it was necessary to do so, where we could not get to the point of understanding what their particular income is. We do not have the information with us.

CHAIR—Ms Lind, you are perfectly free to speak. You do not have to go through Mr Farr.

Ms Lind—That is not what my instructions were!

Mr Farr—We were able to come to a taxable income in those cases.

CHAIR—But how long did it take?

Mr Farr—I do not know.

Ms Lind—I suppose it varies depending on whether we are talking about cases where they were lodging returns essentially on time or soon after the due date, as opposed to those few cases that had been outside the system for some time. In those cases the process is to secure lodgment. We examine what the return looks like to see whether or not the returned income as put forward by the barrister appears to be correct. In most of those cases we have gone forward with commencing the recovery process where those people have not shown any willingness to pay the amount of the tax debt raised as a result of the assessment on the lodged return.

CHAIR—What I am trying to get at is: how much time elapsed in each of these 62 cases before you actually took any action to require a return to be lodged or tax to be paid? Could I have a breakdown of each of the 62 cases?

Mr Farr—Would you like us to take that on notice and provide it to the committee as a table?

CHAIR—Yes, I would. But what I am hearing are answers that tell me you were quite quickly getting onto the fact that someone had not paid their tax, and requiring them to do so, and that each of those 62 people had paid tax. We know that that was not the case in the

Cummins case, where 45 years went by and nothing was done. John Cummins was a very well-known person—a member of the AJC, well known around town, a high-profile defamation lawyer. You must have known that he was not filing a return, so why didn't you do anything about it?

Mr Farr—As I said, initially the mischief was not that people were seeking to disguise how much income was being earned but that they were using the bankruptcy or family law provisions to avoid payment of the tax.

CHAIR—How often did Mr Cummins go bankrupt?

Ms Lind—Once.

Mr Farr—Just the once.

CHAIR—At the end of the 45-year period. So what happened in the interim?

Mr Farr—As I said, we were concentrating not on the people who were omitting their income but on the people who were using bankruptcy.

CHAIR—I want to know why, for 45 years, the tax office was incapable of picking it up.

Mr Farr—It was one case. In any one year, we would handle over three million debt recovery cases and recover in excess of $30 million worth of debt. We handle in excess of three million cases of actually enforcing the lodgment of returns. This was one particular case. Our risk assessment processes are never going to get to the point where we can categorically say that, in every case, we will identify individuals who fall into that category.

CHAIR—But you have brought to us a huge raft of legislation that could have enormous impact. We have received 120 submissions, which have come to us in a very short period of time, that are virtually saying that this is not a sledge hammer but something bigger to crack a small nut. What I am trying to get at is the essence of your problem that requires this huge raft of legislation.

Mr Farr—For a start, we are not bringing the legislation; it is ITSA and the Department of the Attorney-General.

CHAIR—I am going to come to that in a minute, because you were on the task force, big time.

Mr Farr—That is correct. Our primary concern in this whole matter is not about those people who do not lodge returns, as there are other ways that we can deal with that; it is not about those who underestimate their income, because, once again, there are other ways we can deal with that. Our concern—which led to the task force and which we uncovered in the bankruptcy of the barristers—is that, having earned that income, they then positioned themselves by the arrangements they entered into so that, when we did get around to raising the tax debt, they were unable to pay and we were unable to recover a dividend.

CHAIR—Except we know in the Cummins case that that is not true, because you did.

Mr Farr—At this stage, as I said, in the first instance the trustee was successful, but it is on appeal. In a whole range of other cases, the trustee was not successful.

CHAIR—But he did not try; I have just asked you that. You could not give me the name of one case that he has actually taken to court and lost.

Mr Farr—The trustee may be able to do that. We would need to go back and check the cases. But, certainly, in a significant number of cases we have got legal advice that we were wasting our time. It is a pretty expensive business to fund the trustee, if that is what is required, to take a matter through to court. We have to be careful that, firstly, there are reasonable prospects of success, and, secondly, if we were successful a reasonable dividend would be recovered. We have certainly had cases where the advice has been that we would be wasting our time.

CHAIR—I have a small problem with the source of the advice. Nonetheless, the other question that I want to ask—and pardon my having a good memory—is in relation to Mr Keating. I recall of course that he failed to lodge his tax return for two years, and he got a very nice note from the Assistant Commissioner of Taxation saying, 'Please, would you mind awfully popping it in. Here's somebody nice to look after you.' You were able to do that in the case of a high-profile Australian—I think he was the Treasurer at the time—but there are plenty of other people that you must have been able to keep tabs on. Why didn't you do the same thing?

Mr Farr—As I said, we are keeping tabs on a whole range of both high-profile and less high-profile people. But, in the population that we are dealing with, in the number of cases that we are dealing with, there are always going to be some that our risk assessment processes simply do not pick up initially. They are getting better and we are getting better matching. The new tax system is allowing us better matching between various aspects of people's affairs, and we are targeting in on those. But, as obvious as it might look, we are never going to be in a position—when we are dealing with potentially, as I said, over three million debts, $30 million worth of collections a year and over $3 million worth of cases where we are actually enforcing lodgment—to say that we are not going to miss individual people.

CHAIR—Wouldn't your three million debts include mass-marketing schemes, EBAs and a whole range of other things?

Mr Farr—They would include all manner of people who go into debt as a result of the non-payment of tax.

CHAIR—Or the application of the general interest charge?

Mr Farr—If people pay late, the general interest charge would apply, yes.

CHAIR—From your point of view, what is the position when, with the application of the general interest charge, someone who is challenging your amended assessment is sent technically into insolvency? What would be the impact here?

Mr Farr—If someone is challenging the basis of an assessment, it will be very unusual for us to take the matter to the point of bankruptcy or sequestration.

CHAIR—That is not what I asked you. An act of bankruptcy can be committed simply because of your application of the general interest charge—or can it not? That is a good question, isn't it? How would that then impact?

Mr Farr—The general interest charge is a debt due to the Commonwealth, and if a demand for payment is not met it could constitute an act of bankruptcy. As I said, if someone is disputing it, we do not take it to the point of bankruptcy. That is normally done only after the dispute is actually finalised.

CHAIR—So a corporation can be in breach of the Corporations Act in the interim too.

Mr Farr—I am not an expert on the Corporations Act. Normally people in those circumstances would enter into an arrangement with us. We suggest that they pay 50 per cent of the amount in dispute and then we allow the rest of that debt to be held until the matter is resolved.

CHAIR—We will go into that at another point in time. However, there is a difficulty when there is an obligation perhaps on the tax office to bring a test case and the commissioner declines to do so and, in the meantime, the interest racks up.

Mr Farr—Yes.

CHAIR—I am sure my colleagues have questions they would like to ask.

Mr MURPHY—I want to follow on from the chair in relation to the celebrated case of John Cummins QC. You mentioned that there was only that one case, and in that case he did not lodge a tax return for 45 years. In the commissioner's annual report of 2000-01, the legal profession project identified more than 700 members of the New South Wales Bar Association not being up to date with their tax returns—that was about a third of the number of members of the New South Wales Bar Association. Following on from your response to the chair's questions about Mr Cummins: the tax office was unaware that so many members of the Bar Association had not even lodged tax returns. I would like to know how that occurred. You dismissed the chair's question and said, 'That was only one case,' but I can point to your own annual report of 2000-01 and the legal profession project. It is there in black and white. I think that is what was brought to the attention of Paul Barry when he wrote those celebrated articles about the conduct of a number of barristers.

Mr Farr—The fact was that we became aware of that, and Mr Barry wrote those articles as a result of the commissioner himself going public about it. As I said, we deal with a large number of cases and, up until fairly recent times, our ability to match bits and pieces of information to come up with that sort of analysis that you have mentioned was far more limited. We now have far better risk assessment techniques that allow us to do that. As a result of that, the commissioner was able to identify that there were problems within that particular industry and publicly announced that, as well as working to address the mischief that was being caused.

Yes, there were a significant number that were outstanding, though not for the particular period of time that Madam Chair said. Our risk assessment processes at that stage had not picked them up, but they did around the mid-nineties as we got more sophisticated at it, and, at that time, we started to take action to recover. We are also looking at the same areas in other particular industries. We are finding that there is not the same level of systemic abuse that perhaps we saw with the barristers. As I said, we are getting far more sophisticated about it now, but in those times the tools available to us were not at that level of sophistication.

CHAIR—What does that mean?

Mr Farr—For example, imagine the database that the tax office have and our ability to run, say, the barrister's role against our database.

CHAIR—There are not that many of them.

Mr Farr—No, there are not that many of them but, in the context of the volume of operations within the tax office, that is a significant piece of work. We are also dealing with a whole range of other industries and other people who are avoiding tax one way or the other or seek assistance to do so.

CHAIR—Mr Murphy made an excellent point and you really have not answered it yet.

Ms Lind—Perhaps I could give you the current status of the legal profession cases. What we do with the legal profession is match cases with the state legal regulator's list of who is currently practising. We do that on an ongoing basis, so that enables us to establish our population of barristers, which is just short of 4,000, and solicitors who are practising, which is around 40,000. We use that then to monitor them, as opposed to our ANZSIC code where we get a whole range of statistics with a whole lot of other people coming into that data set. Of the 4,000-odd barristers, we now have only 249 outstanding income tax returns. That is for barristers nationally.

CHAIR—And how long have they been outstanding?

Ms Lind—I think that is equivalent to the 700 figure which you might have been referring to from the annual report. I suppose the message here is that we monitor them on an ongoing basis, we are invoking our lodgment enforcement procedures in respect of those cases and we keep pursuing those—in some cases, through prosecution and the court process—until we achieve lodgment of those returns. I think among those figures we have only 17 New South Wales barristers that have returns outstanding for those years, and we are pursuing those cases. So that is built into our ongoing processes now in relation to the legal profession.

Mr MURPHY—I think we are all concerned that such a vast proportion of people who really are the high priests of society should be setting such a poor example that, prior to the year 2000, they somehow could get under the guard of the tax commissioner. That concerns us as representatives of not only the people in this place but the people at large, because it galls people that one can employ bankruptcy and family law to put assets out of the reach of creditors, get away with not paying any tax and still maintain one's lifestyle. These people still walk around with a Medicare card, which you and I fund.

CHAIR—We would still like to know how many of them there were, too, wouldn't we, John?

Mr MURPHY—I certainly would.

CHAIR—How many have gone bankrupt?

Ms Lind—I can give you an overview of bankruptcies from 2001 to the end of the current financial year: we have had 39 in total for barristers nationally—29 of those relate to New South Wales barristers—and the total ATO proof of debt in those cases was around $18 million. At this point we have recovered a dividend of $0.4 million.

As for solicitors, we are still ramping up a lot of our work on the solicitor population. We have had 34 cases of solicitors over that time. The ATO proof of debt was $6.2 million, and we have got a $0.4 million dividend at this time for those cases. Cases for New South Wales barristers certainly peaked in 2001; we had 12. That has dropped down now to around six in each of those years.

Mr MURPHY—I would like to follow on a little bit, Mr Farr. I am not here to crucify you but to just bring to light something which I became aware of because I put fairly exhaustive questions on notice to the Treasurer, the Assistant Treasurer and the Attorney-General. This is relevant to your response to an earlier question from the chair that you would like to take some questions on notice. I am happy for you to take questions on notice, but as a member of this committee I would like some real answers so that we can address these concerns. I have lost track of the hundreds of questions I put on the *Notice Paper*—it was like pulling teeth.

I want to move to another area now. Not only are there barristers not lodging tax returns and not paying tax but some of these barristers work for the tax office. I point to one, Mr Clarrie Stevens, who was employed over a period of something like eight to 10 years by the tax office. Yet the tax office did not identify people like Mr Stevens who were employed by them as not lodging tax returns and paying tax. I find that astonishing. Do you have any explanation for that?

Mr Farr—Yes, I do. In your previous question you expressed concern about these high-profile people, and certainly we did as well. That is why the commissioner made those public announcements. But the figures that Ms Lind read out in overall revenue terms are only quite small; it is the actual public perception of the integrity of the tax system that is the main issue there for us. That is where the level of sophistication of our risk assessment has been getting better—to take into account those factors as opposed to just gross revenue figures.

CHAIR—Mr Farr, we have been down that route. Just answer Mr Murphy's question. He wants to know why the hell you did not know that someone you were employing and paying money to was not paying any tax. It is a good question.

Mr Farr—The answer to that is that the Commissioner of Taxation is also the CEO of the tax office. In a sense they are different people. For the business of running the tax office, the commissioner is not entitled to use the information that he gathers under the relevant taxation laws. In that way he is no different—

CHAIR—Which section of the tax act precludes you from that occurring?

Mr Farr—Section 16 relates only to the use of information for the purposes of taxing; not for the purposes of running the tax office.

Mr MURPHY—I was going to go there next. Bret Walker, the then President of the New South Wales Law Society, wrote a letter to the taxation commissioner about this very issue explaining that you could. Let us be honest: we all know that when someone goes bankrupt it is on the public record. In the public interest and in the interest of protecting revenue, I do not accept that proposition and neither does Bret Walker. Why couldn't the tax commissioner, for example, write to a peak professional body like the Law Society, the Society of Accountants or the AMA—any number of groups—and say, 'This person is obviously not a fit and proper person. They have been bankrupt many times, bringing the profession into disrepute and not making their contribution to this country.' That person could have been struck off and you would not have had the repeat offenders. I will go even further to the next stage where I identified in one of my questions on the *Notice Paper* that someone had been made bankrupt on 12 occasions. I just find that fantastic. Can you offer any explanation?

Mr Farr—None other than we appear to have different legal advice, I suspect, because it is certainly not a proposition that we are against.

Mr MURPHY—I am heartened to hear that.

Mr Farr—It is just that we feel that, based on the legal advice we have got, we are not able to do so.

CHAIR—I am sorry, I do not accept that either. That is a good fudge for why nothing was done—to get legal advice that says we could not have done it anyway. Did you ever try?

Mr Farr—Did we get legal advice?

CHAIR—No. There is the proposition that Mr Murphy has put to you: that you were actually paying money to a barrister—12 years, did you say, for Clarrie Stevens?—

Mr MURPHY—I think it was eight or 10 years.

CHAIR—for 10 years and this man was not paying any tax. He was living a particular lifestyle, which the tax office must have known about. Even given that spurious answer of 'We really cannot use our own information to do our job properly', you have still got your betterment provisions. You should be aware that there are certain high-living individuals. You should be aware of them, assessing them and seeing that they are paying tax. You have got the powers to do it, and in all that period of time, nil.

Mr Farr—That is the area we have discussed previously. I thought Mr Murphy's question was more on why we were unable to use that for the purposes of our contractual relationships, if you like, within the tax office and also on giving information to the Bar Association or other professional association. As I said, we are not against that proposition, but our legal advice is that we cannot.

CHAIR—No, what you said was that under section 16 you were precluded from using the knowledge that you were actually paying money to someone who was not filing a return and not paying adequate tax. In other words, you are saying that section 16 precludes your left hand from knowing what the right hand is doing. I do not accept that.

Mr Farr—It is not a position that we necessarily find totally comfortable, but it is the legal position as we understand it. The commissioner cannot operate outside the law.

CHAIR—It is not a question of operating outside the law. Any legal advice is only that—we have got plenty of examples where legal advice is wrong—and it needs to be tested. Are you saying that you could do nothing for all those years and not get any tax from these people—not use your knowledge to go against this man, for instance, and not use your betterment provisions? Do you have a task force whose job it is to see who is out there living high on the hog and not paying any tax?

Mr Farr—I think you are referring to high-wealth individuals. Yes, we have a task force. But we are probably getting a number of different things mixed up together.

CHAIR—Yes, and we are capable of dealing with several at a time.

Mr Farr—In respect of our contractual arrangements with barristers, or anyone else, our legal advice is that we cannot use information gathered under the tax act to deal with that. That is not something we would prefer to be the position, but that is the position.

CHAIR—I would like to see that piece of advice and who gave it to you, because I find that spurious in the extreme. Can you obtain that legal advice for me, particularly showing what date it was sought?

Mr Farr—Yes.

CHAIR—I am sorry, John; I interrupted you.

Mr MURPHY—We may have already exhausted our time—

CHAIR—We are going to go a little bit longer.

Mr MURPHY—I would like to move to the issue of the checks the commissioner does before the tax office employs people—for example, people like Mr Stevens. How do you employ someone with a record like that to do work for the Commonwealth?

Mr Farr—It is not an area that I am an expert in.

Mr MURPHY—Nor am I.

Mr Farr—Certainly we are moving in some of our larger contracts now to say—

CHAIR—'Do you pay tax?'

Mr Farr—Basically. It is a bit more complex than that. When it comes to barristers, in the majority of cases we engage the Australian Government Solicitor or another instructing solicitor, and they employ the barristers. In those cases we rely on the Australian Government Solicitor and whatever process they go through for selection and vetting. In that case, we would basically be relying on AGS.

CHAIR—Is this the case with Mr Clarrie Stevens?

Mr Farr—It would have been, as far as I am aware, yes.

CHAIR—'It would have been'—this is a very high-profile case and you do not know?

Mr Farr—The instructing solicitor would have been the person responsible for engaging the barrister. I cannot remember in that particular case whether AGS were the instructing solicitors or not.

CHAIR—Pardon my going back into my memory, but I do recall that you have something known in the tax office as RATs.

Mr Farr—I do not think it is called RATs anymore.

CHAIR—Did you change its name?

Mr Farr—It has changed its name, yes.

CHAIR—This was a category of people who are high-profile people who you used to keep a special eye on. Is that a good description of it?

Mr Farr—That is right, yes.

CHAIR—I remember the Phillip Smiles case very well. He was ruined as a member of parliament on a decision by the tax office. He was vindicated subsequently on appeal, but the damage was done. You have a track record in the tax office of keeping an eye on individual people, so how come these high-profile people did not have an eye kept on them?

Mr Farr—I do not know that I can add much more to my previous explanation—that in the overall scheme of the operations of the tax office there are only a very small proportion of these individual cases, and our risk assessment processes simply did not pick them up at the time. A whole range of people, whether high-profile or otherwise, were certainly picked up. We have dealt with, as I said, a very large number of debt cases and lodgment enforcement cases.

Mr MURPHY—Can I also ask you about the industry codes you use. I draw attention to question on notice No. 43, which I put to the Treasurer on 13 February 2002. It was a very simple question:

What percentage of (a) barristers and (b) solicitors pay the top marginal rate of income tax?

Of course, the answer I got was one that clearly indicated that most members of the legal profession are not paying the top marginal rate of tax, but grouped within this legal services industry code are advocates, barristers, conveyancing services, legal aid services, notaries and solicitors—so some people who follow occupations that do not require legal qualifications. In view of the very poor example set by the high priests of our society—the barristers—why is it that the taxation commissioner cannot have a discrete industry code for those members of the legal profession to find out just how little tax they are paying? My question showed that more than half were not even paying the top marginal rate of tax. I think that, if the public understood that, they would be horrified because they would think that anyone with a law degree would be able to earn $60,000-odd—

CHAIR—Not so.

Mr MURPHY—Well, I find that astonishing.

CHAIR—There are some at the top of the profession who make a lot of money; there are quite a few down at the other end of the profession who do not.

Ms Lind—We have the ability to rerun that analysis now based just on the discrete population of practising barristers and solicitors, so we can take that on notice for you.

Mr MURPHY—My purpose for raising that is not that my target is members of the legal profession; it is that I suspect there are other professionals who have also arranged their tax affairs where they are paying what I and the man on the street would describe as not their fair share of tax. All of us in this place want to make sure that people who can afford to pay tax do pay tax, because it seems that the ordinary pay-as-you-go taxpayer, which is most of us, pay through the neck and do not have much opportunity to minimise tax. These industry codes concern me. Can you give me a brief response on what could be done about those. For example, I would like to have a look at medical specialists. That would be an interesting one to have a look at.

Mr Farr—The ANZSIC codes themselves are really the province of the department of statistics, and they are mainly used for statistical purposes. They set what the codes are; we rely on that to a certain extent. We have found that we need a much greater level of granularity, as you have pointed out, and as Ms Lind said we are now getting to a point where we can distinguish some of those things. In terms of other high-profile professions, we have had a look at number of those professions. Ms Lind mentioned that we have started looking at solicitors, and it is relatively early days with that. We have also looked at professions such as architects, doctors and accountants, so we are starting to go through those professions. Although we find some instances in each of those where people have set out to avoid the payment of tax, there is not the same level of systemic issue that we have found with barristers. But we will continue to explore and we will continue to look at those high-profile professions all the way through our compliance program.

Mr MURPHY—Mr Farr, have any magistrates or judges failed to lodge their taxation returns on time? Have any magistrates or judges gone bankrupt?

CHAIR—No, because they lose their appointment. They are like us: if you are bankrupt, you are out of a job.

Mr Farr—I am not aware of any. We can check but I certainly am not aware of any.

Mr MURPHY—I would like you to check whether you have any record of the details of any magistrates or judges who have not lodged their tax returns on time and whether any of them employed bankruptcy to avoid paying their creditors. I understand what you said, Chair—I understand that clearly.

Mr Farr—We will take that on notice.

Mr SECKER—I would like to get clarification on one thing first. You mentioned that three million people or entities, I think, had not lodged their tax returns, involving $30 million. That is an average of only $10 per person or entity. Are those figures right?

Mr Farr—I said that, in any year, about three million people who owe us money go into debt—they do not pay within the prescribed time line—and we are required to take some action to enforce that lodgment. We also enforce lodgment of returns. Last year, for example, there were about 3.3 million cases where we took action to enforce payment of activity statements or lodgment of activity statements and also about half a million cases where we enforced the lodgment of an income tax return.

CHAIR—How many for income tax?

Mr Farr—About half a million.

CHAIR—How did you realise that they had not filed a return?

Mr Farr—By looking at our records and seeing which had not lodged a return. We have to make an analysis of whether they should in fact have lodged—whether they fall into a category where it is not necessary for them to lodge. Within the resources available to us, we then need to look at what the highest risk, the highest amount of revenue, is around each of those where we can turn our attention to lodgment enforcement.

CHAIR—That would have included someone like Mr Keating?

Mr Farr—I know nothing about that case, and it would probably be inappropriate—

CHAIR—Of course you know something about that case—everybody did. All I am saying is that he was someone who failed to lodge a tax return for two years. That would be included in your half million—that sort of person?

Mr Farr—Anyone who has not lodged their tax return at the time it becomes due would fall into that category.

CHAIR—So they could be six days overdue and be in your number?

Mr Farr—No. If they were six days overdue we would not be—

CHAIR—Six months overdue and they would be in your number?

Mr Farr—Quite possibly, if they were at a high enough level.

Mr SECKER—That has gone right off the track of where I was heading.

CHAIR—Sorry, I beg your pardon.

Mr SECKER—Where is the $30 million figure coming from, Mr Farr?

Mr Farr—The $30 million is the amount we collect.

Mr SECKER—So it is an average of $10 per person—

Mr Farr—Sorry, that should be $37 billion. That is the amount we collect from people who go over time.

Mr SECKER—That makes a lot more sense than an average of $10 per person. It just seems to me that with the GST system, quarterly reporting, quarterly payments for things like WorkCover and superannuation and, in some cases, monthly payments, you would have a far better system now for catching people who are not doing the right thing.

Mr Farr—That is correct. That is where we are getting much better at matching—in the sophistication of being able to match across various files.

Mr SECKER—Certainly you would think that someone would not be able to avoid paying tax for 45 years under this system.

Mr Farr—You are always going to get individual cases that are not going to be picked up in the risk assessment. What we will hopefully be able to avoid is any widespread systemic abuse across a range or a segment of taxpayers. Just on the number of people, or cases, we deal with each year, there is always going to be the odd case that is going to slip through. So I cannot give any guarantee that there will not be one or two cases like that.

Mr SECKER—In the employment of a contractor—such as the case we had with Clarrie Stevens that you brought up, John—do you use a withholding tax or something like that? If you employ them and pay them a certain amount, would you withhold tax as part of the contracting system?

Mr Farr—No, generally not—but that would depend on the contractual relationship. We would have no ability or obligation to withhold tax in, say, the case of a barrister engaged by the Australian Government Solicitor on our behalf.

Mr SECKER—But if I have a contract with someone on my farm, unless they give me some sort of number, I have to apply a withholding tax.

Mr Farr—Unless they provide an ABN to you, you must withhold tax.

Mr SECKER—But you still have to take so much tax out of it, don't you?

Ms Lind—Not if it is on a contract basis and they disclose their ABN to you.

Mr SECKER—Coming back to the Cummins case, it is on appeal. You have obtained half of the matrimonial home for tax debt purposes. If that appeal were quashed, wouldn't that mean you would actually have the powers now to take on these high-profile cases and go back so many years? Then we would not need this legislation at all.

Mr Farr—That would depend on the facts of the individual case and, of course, the judgment. We are not waiting for that to actually attempt to recover in these cases. We spend about $10 million a year on legal advice and legal action in this recovery area. On average, we would spend over $1 million a year funding trustees to operate on our behalf to recover money. Depending on the nature of the judgment, it might give more comfort to the trustees to be able to do that. We are not waiting for that. Where we think we have a reasonable chance of success, where we think we have the ability to recover some money, we are actually taking that action now.

Mr SECKER—I assume it is Cummins who is appealing, is it?

Mr Farr—It is his spouse.

Mr SECKER—If the appeal were upheld I think we would have a much stronger argument to say that we need these laws because we have been shown by a court case that the ability to take half the matrimonial house has been thrown out. But you are not going to wait until that decision, which, to me, is a key to whether we need this legislation or not.

Ms Lind—Justice Sackville has made some commentary in that case where he is actually looking more broadly at the provisions of sections 120 and 121. He has found in the trustee's favour based on the particular circumstances of Cummins. That commentary suggests that section 121 would not be effective in all cases. I do not have the reference.

Mr SECKER—But it would have to make some difference to what sort of legislation is put up. If the appeal were quashed, you would not need such stringent legislation, I would have thought, even on the basis of it only being in this case. It might not reflect on all cases. If the appeal is upheld then I think we have a much stronger argument to say that we have been shown that the system is not going to allow us to go back to what happened 10 years ago. It just seems strange to me as a legislator that we could be making decisions based on an unnecessary requirement.

Mr Farr—It would depend on the nature of the decision and the facts of that particular case. We are not waiting, as I have said, but we have been unsuccessful and we have had adverse legal advice in the past.

Mr SECKER—But that adverse legal advice was not right in this case, was it?

Ms Lind—We have had other cases where family maintenance arrangements have been used. That was one of cases we were talking about earlier—it was not tainted money provisions but maintenance agreements provisions that would assist in those cases.

Mr SECKER—I am not sure whether you have the expertise but I would not mind your personal view on this—if accountants become bankrupt, they are struck off from being chartered accountants; if judges are bankrupt, they are stopped from being judges; if politicians are found bankrupt, they are stopped from being politicians. Shouldn't barristers, if they are bankrupt, be struck off from being barristers? Wouldn't that be a pretty strong disincentive?

Mr Farr—It was probably the turning point of our dealings with the barristers when the relevant associations inquired about whether being bankrupt actually made you not a fit and proper person to practise—that was the real disincentive. As soon as the Bar Association and others started to do that, we found a whole range of barristers started paying. Cases that were on the way to bankruptcy were paid in full immediately. So, yes, that is a significant disincentive for those people. The work that the Bar Association did—and we worked with them—was certainly beneficial in that, as it would be in most of these high-profile professions.

CHAIR—Following up on that question from Mr Secker, we first discovered all these things were happening back in the mid-nineties. How come it took until the 2000s to get the Bar Association to agree to disbar practitioners who go bankrupt? It is not really very hard.

Mr Farr—We started talking to the New South Wales Bar Association, as I said, in 1997. But I think it would be fair to say that at that stage they did not see that as a primary consideration for being a fit and proper person. Subsequent to that, the publicity that came out and the work that we did with them—including, as I said, the commissioner's speech in September 1999—that view was changed and there were also changes to state legislation requiring bankrupts to provide that information. So there was a change around that time, and it was, I have to say, from our pushing on that.

CHAIR—With regard to the legislation that has come before us, is there any precedent in any other jurisdiction for this type of legislation creating a category of tainted property and an act of tainting?

Mr Farr—That is a question you would have to direct to the Attorney-General or to ITSA. I am not an expert on that area, I am sorry.

CHAIR—The tax office was very instrumental or was very much a part of the task force that looked at this question.

Mr Farr—Yes. What the task force was looking at was for those people in the legal profession who very clearly had set out to enter into arrangements where they never intended to pay any tax. That was the concern that we had, and that is what we were clearly addressing. The current exposure draft of the bill is more broad than that. It gives no preference, nor does the commissioner seek any preference on that; it goes to the rights of creditors generally. In a sense, in the overall scheme of things, we are only a minor player. This is generally a much more major issue across the community.

CHAIR—I wanted to come to that, because all our conversation has been about high-profile people who have not complied with their taxation obligations, yet there is absolutely nothing in the bill that says it is only to apply to these people; it applies to everybody. I want to give you an example. Supposing we have Mr and Mrs Smith, who are married; he buys the house; she makes no financial contribution, but during the course of the years through love and services rendered he transfers half the house to her. The business he has been in is that of a panel beater. He conducts this business of panel beating, and he uses the house which is now owned by both of them as security for his business. They go along for 15 years and then they get divorced. On the divorce settlement, she gets the house and the panel beater keeps the business. He keeps going, and five years later he goes bankrupt. What is to prevent the trustee in bankruptcy going back to attack the property that has been given to the wife by way of the divorce settlement as being tainted property, because in the beginning half of it was given to her which would have protected that asset and therefore it would come within the definition of an act of taint?

Mr Farr—That is probably a technical interpretation of the legislation—

CHAIR—Most interpretations are.

Mr Farr—yes—that would be better asked of ITSA or the Attorney-General's Department.

Ms Lind—You would probably need to look at the exempt full-value transfers because, in that case, the trustee has to form a view that the bankrupt had a tainted purpose at that time.

CHAIR—Correct, but here is the problem: that makes the divorce settlement uncertain. One of the concerns I have about the legislation is that, by creating this situation, you can put certainty in jeopardy. There seems to be, with the whole thrust of the legislation, an attempt to quarantine creditors from risk. If you are a creditor and in business you must accept some risk. You always have to accept risk, whether it is greater or lesser risk. This legislation seems to want to quarantine creditors from risk.

Mr Farr—I think that goes to the overall balance of the legislation. As I said, we are only a small player.

CHAIR—You are a big player. You are a big pusher. You are big reason for it.

Mr Farr—Our primary concern has always been those people who, at the time they set up the arrangements, deliberately set out never to pay tax and to use the bankruptcy law—

CHAIR—But Mr Farr you have already told us that the moment the Bar Association made it the case that you would be disbarred if you went bankrupt the practice virtually ceased.

Mr Farr—It is certainly a lot better than it was; that is correct.

CHAIR—So why aren't we looking at those sorts of solutions?

Mr Farr—We are—absolutely.

CHAIR—So how would this enhance the situation? Only because it is retrospective. Answer the question, please.

Mr Farr—It gives greater right to the—

CHAIR—No. If we have stopped the practice, it is no longer a problem. But, if you have people who have in fact used the bankruptcy provisions, then this is only of value because it acts retrospectively. Is that right?

Mr Farr—It has the effect of taking all of the assets that are either—

CHAIR—It is retrospective. Can't you say the word?

Mr Farr—But I do not think it is a question of being retrospective or non-retrospective. It is about the assets that are held either directly or beneficially at the time of the bankruptcy.

CHAIR—No. You can go back 50 years; there is no time restraint.

Mr Farr—To look at individual transactions, but—

CHAIR—There is no time limit on anything in here, so it is retrospective in nature—which would make it valuable to you. Isn't that right?

Mr Farr—It would certainly make it valuable to us.

CHAIR—Thank you.

Mr MURPHY—I have a couple of quick questions because I know we have gone over time. I would like to return very briefly to Mr Cummins. Can you report back to us on why the taxation commissioner required Mr Cummins to lodge tax returns for only seven years—30 June 1992 to 30 June 1999—and why he was given a tax-free exemption for 38 years? I think that galls a lot of people in view of the lifestyle he led. I will give you a plus for finally nailing Stephen Archer. The celebrated cases have involved a number of barristers, including Mr John Cummins QC, Mr Stephen Archer, Mr Clarrie Stevens QC, Mr Bill Davison, Mr Timothy Wardell, Mr Wayne Baffsky, Mr Robert Somosi, Mr Roger de Robillard and Mr Tom Harrison—there are certainly more than one. My concern is: why did the legal profession project get dropped off the taxation commissioner's 2001-02 annual report? I think that stinks.

CHAIR—Is that right?

Mr MURPHY—I am not directing this personally at you, Mr Farr—make no mistake about that. I am just standing up for the public interest and the long-suffering taxpayer. I think that that team did an excellent job with what they reported in the 2000-01 annual report. The Taxation Office obviously was left in very bad odour with the revelations of some of these barristers I have just named—and there were others—and the work of that team did not appear in the following annual report. I have relentlessly asked questions of the Treasurer and have been dismissed regarding this. The answers served up from the taxation commissioner's office, as far as I am concerned, were totally inadequate and just tried to whitewash the matter.

Thankfully, after the hundreds of questions I asked, the work of the team appeared in the following annual report. But that left a very bad taste in my mouth and in the mouths of the people screaming at me and saying: 'What are you doing about it? You're my local member.' And there were others who approached me when they saw from the *Notice Paper* what I was doing to respond to this, because people get sick and tired of so-called clever criminals who do not pay any tax and think it is very clever and, as I said earlier, walk around with their Medicare cards bludging off our society. I think that stinks and so do most fair-minded Australians.

Mr Farr—I cannot answer the question as to why it was not included in there. It was a major issue but it has quietened down since then, and I guess that must have had regard to that. But I do not know the answer.

CHAIR—I think we need to know why it was dropped off. That was a good question. I ask you to take it on notice and find an answer for us. When we come to the question—and we have not dealt with this yet this morning—of the relationship between the family law court, bankruptcy and avoiding payment of tax and other creditors, I think we may have to have a second session. We will not attempt to do that today; we will have a second session to deal with that precise issue. I put on the record the Jodee Rich case. He did undo the damage—an action was taken. Would you like to say a couple of words about that, bearing in mind that it is something we will pursue in depth at a second session?

Mr Farr—I cannot, because I am not familiar with the case at all.

CHAIR—You cannot say you are not familiar with the case. The whole world is familiar with the case. Whether you have any expertise or detailed knowledge is a different question.

Mr Farr—I do not have detailed knowledge.

CHAIR—I put it on notice that we would like somebody, when we come back to address this question, who does have detailed knowledge.

Mr Farr—Yes.

Mr MURPHY—By way of finality from me to Mr Farr, bankruptcies increased threefold in the period 1989-90 to 1999-2000 and there was a sharp increase in debt agreements during that period. I would like you to get a transcript of today's proceedings, because we have asked far more questions than you have been able to jot down and give us answers for. At our next hearing, I would like you to attempt to give us more substantial responses than the ones I got in response to questions on notice to various people, principally the Treasurer and the Assistant Treasurer. I would like you to look at that transcript and the things that I have raised, because they are things that are of concern to me. This is not a personal attack on you or Mr Carmody, but let us get this right from now on and have confidence in the system. Of all people, you would expect the members of the legal profession to be setting the best examples.

Mr Farr—Certainly.

Mr MURPHY—Thank you.

[10.18 a.m.]

HARTCHER, Ms Judith Lorraine, Business Policy Adviser, Certified Practising Accountants Australia

MANN, Mr John Laurence, Chairman, Board Public Practice Committee, Certified Practising Accountants Australia

PURCELL, Mr John Anthony, Technical Adviser, Certified Practising Accountants Australia

CHAIR—Welcome. We have received the submission you sent to us and we have authorised it for publication. I note that we are now receiving a copy of your opening statement and a supplementary submission. It is moved that the submission be received and authorised for publication. Would you now like to make your opening statement.

Ms Hartcher—I would like to go over the roles that we have. I am the business policy adviser and the small business spokesperson for CPA Australia. Mr Mann is the chair of our Public Practice Committee, representing 16,000 public practitioners, and he also has his own practice in the ACT. John Purcell is our technical adviser on this matter. Thank you for the opportunity to present today. CPA Australia is a professional body with over 100,000 members, of which around half either advise or work in small to medium enterprises. Our submission was based on our understanding and experience of the small business sector, with research showing that more than 80 per cent of small businesses approach their accountant for advice.

CPA Australia supports the intent of the bill and recognises the importance of an effective bankruptcy regime that creates an orderly, fair system to allocate available assets of a bankrupt to creditors and provides a solution for a person in an unsustainable financial position. The system should also safeguard the community by restricting further financial activities by insolvent persons. On this point, CPA Australia's by-laws prohibit members who are bankrupt from practising and it actively investigates and acts on any breaches.

However, the bill will have an impact, broader than its stated objectives, on the business community, particularly on smaller businesses that do not incorporate in order to maintain simpler, less costly structures. CPA's main concerns with the current bill relate to the lack of consistency between the bill's objective and the structure of the arrangements. These include the retrospective aspects of the bill, the lack of recognition of the specific characteristics of debtors entering into bankruptcy and the increasing divergence between personal and corporate insolvency regimes. These issues are covered in our submission, so I will not elaborate on them here.

CPA Australia is also concerned about the impact the bill could have on business behaviour, if implemented. Only around 7.5 per cent of businesses exit each year, with the majority of these being voluntary cessations. Less than half a per cent of businesses exit as a result of bankruptcy or insolvency and yet a large proportion of the 1.6 million small businesses, most of which are extremely unlikely to go bankrupt, will react negatively to the law and take actions which would

not normally be considered. Some consequences may be that sole traders and partnerships will move to incorporate and will incur significant costs in order to move their assets to new business structures. The cost and complexity of changing will be too much for some businesses and they will decide to cease business. It must be recognised that many businesses operate on very small margins and cannot afford unexpected expenses. And investment in the sector will be impacted as business owners balance the risk of losing family assets against possible gains. While these outcomes may sound dramatic, they are not outside the realms of reality within the small business sector.

Any business enterprise is subject to risk and it is not feasible to attempt to legislate away risk for some sectors of the business community. The ATO, which was a major creditor in the cases of initial concern, already has extensive legislative recourse to ensure that its debts are recoverable and it needs to exercise these powers. CPA would like to propose some options for the committee to consider, and a copy of these proposals has been provided to the committee. Broadly, our proposals include an adoption of a three-tiered approach to the abuse targeted in the bill. This approach would involve, in the first instance, ensuring that the collection and recovery regimes contained in the Income Tax Assessment Act and the Tax Administration Act have been fully pursued. Secondly, it would involve ensuring that the existing mechanisms in the Bankruptcy Act, which make property available for the payment of debts, have been applied. Finally, it would involve ensuring that there is resort to the appropriately modified and carefully targeted extensive powers envisaged in the bill. We are happy to elaborate on any of these or on any aspect of our submission.

CHAIR—Thank you very much. You state that you support the intent of the bill. What do you think is the intent of the bill?

Mr Purcell—That is where there was a little bit of trouble, from our perspective, in developing a submission. It is clear that the bill is designed to attack large-scale, tax abuse motivated bankruptcy. The explanatory memorandum focuses on the issue of tax evasion on a substantial scale, particularly amongst professionals. That was the stated objective in the explanatory memorandum and it is very heavily the theme of the joint task force. None of that in any clear manner has translated into the terms and the wording of the draft bill as it stands at the moment. There are a number of layers of issues here. Some of them may be tax related, based on the wording. Underlying that are issues to do with asset protection. Many of those asset protection arrangements have been traditionally valid methods by which people who are unwilling or unable to incorporate have managed their risk without having any contemplation whatsoever of events of bankruptcy or creditors to whom they might at some stage seek to avoid their valid claims.

CHAIR—Do you agree that the divorce settlement in the example I gave of the man and wife and the panel beating business could be attacked? Do you want me to give the example again?

Mr Purcell—I quite clearly recall the example. Yes, those types of arrangements are potentially going to be subject to the encroachment of trustees. That is another aspect of concern about the bill as it stands. Whilst you might have very clearly stated objectives and purposes within the explanatory memorandum, those do not necessarily translate to 10 years further down the track when these powers are put in the hands of a trustee who may take a very aggressive

stance in a bankruptcy which has no real bearing on or relationship to what the original ill and mischief was.

CHAIR—I note you said in your opening statement that some small businesses may move to incorporate and that that would be inappropriate for their businesses because of the expense that is involved in doing so. On one reading of the bill, you could possibly say that turning your business into a proprietary limited company could be an act of tainting—

Mr Purcell—Potentially, yes.

CHAIR—because the purpose could be to prevent the assets being distributed to creditors.

Mr Purcell—The themes that we have tried to build into our submission do not only centre around business certainty. I think there needs to be a recognition that incorporation is a concession provided by the state to encourage investment and valid risk taking. Whilst incorporation exists for those purposes, behind it is a whole range of checks and balances to make sure that it is not abused. Whilst you particularly work within a partnership type arrangement of joint and several liability—

CHAIR—We got rid of joint and several liability, didn't we? Getting rid of joint and several liability in negligence actions has been a big plus for people who operate in partnerships, hasn't it?

Mr Purcell—Yes. That has been a recent development. We have had some concerns, particularly in the area of professional indemnity insurance. We certainly recognise the fact that changes have taken place there which make that environment in particular more certain for practitioners in the future.

Dr WASHER—You mentioned that accountants cannot practise if they are bankrupt. How long after a bankruptcy would you be prevented from practising as an accountant?

Mr Purcell—I need to go back and check this but my understanding was that, whilst accounting practice is not a regulated form of profession, any person can effectively put up a shingle and practise as an accountant. Nonetheless, the principal membership bodies apply quite rigorous rules in relation to continuing to practise and not being able to hold yourself out as being a CPA. I understood that those prohibitions on being able to hold yourself out as a CPA or to use CPA Australia's intellectual property in terms of its branding ran for the person concerned up until the point of discharge from bankruptcy.

Dr WASHER—In your opinion, then, would that be a major deterrent for people using the Bankruptcy Act to avoid paying tax or the like?

Mr Purcell—I would have thought it a very substantial disincentive. The market for accounting services relies very heavily on reputation built around brands, both of CPA Australia and the other principal membership bodies.

Mr Mann—Speaking on behalf of a practitioner, the answer is yes. It is definitely a deterrent because one of the most important parts of our practice is to say we are CPA members; we are a

CPA practice and we use the intellectual property of CPA Australia—we use the logo, the name—and it is very important to us to say that we are CPAs and not just that we are accountants.

Dr WASHER—So, as the chair suggested earlier, making people aware of someone's bankruptcy publicly and stopping or inhibiting someone from working in their profession in a functional way would resolve the problems that this bill is trying to address if we made that widespread.

Mr Mann—It would be very embarrassing, yes.

Dr WASHER—The other thing I wanted to ask is: you mentioned that you felt that there would be a lack of innovation if this bill was applied as it stands. Can you flesh that out?

Ms Hartcher—We have had some feedback from members saying that they would seriously reconsider their investments in businesses if this bill goes ahead. The small business sector is not always very logical in its response to matters. Even though a business may be incorporated, once there is a certain amount of fear about investment and possible loss of assets that would have a major play-through around the sector.

Dr WASHER—My last question relates to the bullet point given in your handout, which recommends that the bill should:

... ensure that the existing mechanisms in the Bankruptcy Act which make property available for payment of debts have been applied.

I do not know the act in detail as well as you would, but I would have thought that the act had some teeth in it currently. In your opinion, what is deficient in this act so that the Australian Taxation Office would not currently be able to access debt? Is this section 16 that they talk about so important? Flesh it out. Can you see their problems?

Mr Purcell—Certainly as the Bankruptcy Act stands at the moment—and this is one area of divergence from Corporations Law—section 121, 'Transfers to defeat creditors', does not have any time limitation placed on it. So there are quite extensive powers already within the Bankruptcy Act to pursue transfers. There may be issues around proof associated with that particular section, but what we have in front of us now is a disproportionate response. From our reading, it does not show any hard empiricism of how the existing provisions of the Bankruptcy Act as a second tier—certainly away from initial pursuit under the Income Tax Assessment Act—fail to such an extent to warrant the scale and breadth contained in the draft bill. Apart from questioning that, our proposal at least tries to make some suggestions for making sure that, at least through a process of judicial review on a case by case basis, there is some very clear assurance that those extensive powers given to trustees in the Bankruptcy Act are fairly and fully exhausted before these later stronger powers come into play.

Mr MURPHY—In your opening statement you talked about your main concerns being:

- The retrospective aspects of the Bill;

- Lack of recognition of the specific characteristics of debtors entering into bankruptcy; and

- The increasing divergence between personal and corporate insolvency regimes.

You talk about your proposals, including an adoption of a three-tiered approach to the abuse targeted in the bill, which you said would ensure that the collection and recovery regimes contained in the Income Tax Assessment Act and the Tax Administration Act have been fully pursued. What are your concerns there? We are probably reasonably satisfied that the ATO has not fully pursued some members of the legal profession, but what are your concerns?

Mr Purcell—The way that this is presented is partly built around trying to position recommendations that provide some sort of substance. We are confident that, where applied fully and exhaustively, the Income Tax Assessment Act treats the vast majority of situations. By recommending a three-tiered approach, we are saying that, if there is an insistence on providing these types of powers to trustees, there should be checks and balances along the way to ensure that, first, the ATO will fully utilise its powers in a particular case being sought and the process will then engage these larger powers.

Mr MURPHY—I am not quite sure what you mean. Can you give me an example of where you think the ATO is not going far enough so I have a better understanding of what your concerns are for business?

Mr Purcell—A simple case is where company directors are personally liable for the payments of PAYE. There are quite extensive powers in section 222AOB which enable a company director to enter into an agreement with the Australian Taxation Office to either get some temporary relief or enter into some form of an arrangement to make those payments of tax instalment deductions. In that case, failing a company director's capacity to fulfil those obligations, we would like to see that the company director concerned has had fair and reasonable opportunity to avail themselves of those limited safe haven provisions within the Income Tax Assessment Act, which would provide both protection to the director and an assurance to the revenue that a serious attempt has been made. We are suggesting that those various details be fully pursued, and that it be understood that they have been fully pursued, before the very crude tool—for want of a better expression—of bankruptcy is used to pursue personal assets.

CHAIR—I would like to ask you about one of the essential ingredients of the bill—and that is this whole new concept of tainted property. Are you aware of any other jurisdiction, internationally, that has such a concept?

Mr Purcell—Within income tax legislation there are notions of tainted income. Tainted income has about it sourcing in tax haven type jurisdictions. 'Tainted' is clearly a pejorative. I am not aware of any overseas bankruptcy arrangements which have within them this type of notion, which takes clearly understood legal perceptions of property and then, at the assertion of a trustee, gives a tainted nature to them.

CHAIR—Many of the submissions that have come to us talk about a reversal of the onus of proof, in that the provisions seem to act on a deeming system. Where property has been transferred and you subsequently become bankrupt the property is almost deemed to be tainted. In that very simple instance it is then up to you—and you may be the third party or the entity to

which it is transferred—to prove that you fit within the criteria in the bill of having made full payment. And there are a couple of other things that you have to prove. The court may find that it is still—

Mr Purcell—It is still running within a 10-year limitation.

CHAIR—There is no limitation.

Mr Purcell—If you could bear with me, there is one 10-year time limit.

Ms Hartcher—That is the property transfer value.

Mr Purcell—Fair value.

Ms Hartcher—The retrospective nature of the bill is also inconsistent with record keeping requirements. There is no legislative requirement for businesses to keep records beyond various periods for various different acts. So it is highly unlikely that a business required to prove something more 10 years ago would have any records of that transaction.

Mr SECKER—The transfer of an asset like a property asset would be recorded for time immemorial.

Ms Hartcher—Yes, that would apply to major ones, such as real property perhaps, but there are a lot of smaller transactions they would not keep.

CHAIR—I will go back to the example I was giving. A bankruptcy could occur many years after property had been transferred but it is still subject to being attacked—even if it happened 50 years before.

Mr Purcell—Yes. It all centres around the wording in section 139AFA.

CHAIR—There is also a provision, I think, that where there is money or property which could potentially be recovered the court is given an exhaustive list of factors that they have to consider.

Mr Purcell—Yes, and it cannot go beyond those factors.

CHAIR—We have already got into the area of uncertainty because we are now before a court which has discretion. So the trustee can take action, which is going to put the certainty of somebody's title at risk. The court must consider the nature and extent of any interest owned by another entity in a property and any hardship that would be caused. Yet we do not seem to have a definition of hardship.

Mr Purcell—That is one of the points we make in our supplementary submission. Whilst hardship is introduced as one of the measures which the court may take into account, it does not provide any definition of what hardship might be. Also we are asking, notwithstanding that uncertainty, that they also be given greater powers in a couple of areas. One is to consider what might be excessive versus non-excessive transfers. We also ask within that particular section that

a power be given to the court to consider the extent to which the other avenues of the Bankruptcy Act have been fully availed of before granting the types of orders being sought.

CHAIR—What impact do you think this could have on lending? I am thinking of small businesses, which very often use the family home as the source of raising the capital to run the business and the house is up against it. If one partner has transferred an interest to the other partner and that partner is then guaranteeing it as well, what impact would that have on banks thinking to lend money to a small business?

Mr Purcell—There are potential consequences which we are really going to find out once this type of the bill came into place. To merely speculate what could happen, arguably, given the fact that the bill is designed to protect unsecured creditors, particularly the ATO, but still it is written in terms to protect unsecured creditors with no definition given to what class of unsecured creditor it might be, potentially there is response from those who can take security to take more security or to cost adjust within their lending to cover the greater risk now proposed by this bill, the uncertainty related to business transactions into the future.

CHAIR—Given all the discussion we have had about this whole raft of legislative provisions being aimed at professional people who basically cannot incorporate, is there any point in saying in the intent of the bill that it only applies to certain professions? It is very difficult, isn't it? You could then say, 'All right, I'll be a barrister and a part-time plumber,' and put income against one category, which I guess is why we are in this situation. Are there other ways you have thought of that we can solve this problem without going to the route of having the concept of tainted property? Or do you agree with the concept of tainted property?

Mr Purcell—To give a personal opinion, no, I do not agree with the concept of tainted property. It really cuts to the heart of what people's understanding is of what they are able to do with their property. Unless there are events associated with deliberate evasion of creditors with knowledge of impending bankruptcy, people should be free to structure their business arrangements, secure their property against those businesses in a manner which is commercially expedient for them. I do not think in the wording you can presume that by default it is only going to apply to the mischief which happened a number of years ago. I cannot be confident at all that that would be the outcome.

Mr MURPHY—Following on from that and bearing in mind that these amendments only apply to unincorporated small businesses, would you then form the view that these proposed amendments are a disincentive to small business?

Mr Purcell—Yes, very much so.

CHAIR—The act of forming a proprietary limited company could be an act of taint.

Mr MURPHY—Yes.

CHAIR—I am interested in looking at statistics that were provided to me concerning data about bankruptcies of professionals from 2002-04. Barristers were the people singled out in 2002—there were seven barristers who went bankrupt, owing total debts of $2.449 million, of which the tax office was owed $1.4 million. In 2004, there is one barrister who has gone

bankrupt, owing $305,000, of which the tax office component is $157,000. Saying that you lose your right to practise does seem to be having a definite effect, as was said.

Dr WASHER—If I were to trade in a fashion that was not appropriate—for example, because I knew that I was going to be insolvent—how far would the current Bankruptcy Act take us back to look at what property I had transferred? Is there currently a 10-year limitation?

Mr Purcell—No. Particularly in section 121, dealing with transfers to defeat creditors, there is no time limitation on it.

CHAIR—As a final question I would like to ask you the question I asked of the tax office. In a way, the effect of this legislation does seem to be to transfer all the risk that creditors may currently assume—either by doing business with someone or in the case of the tax office by not getting their fair share—away from those creditors so that they assume no risk and there is an absolute ability to recover by tracing property through a great labyrinth if necessary. It seems to me that if you are in business you must take a risk—it is going to be a greater or a smaller risk according to what your rate of return is and what your reward for the piece of business you are doing is. Do you agree with that assessment?

Mr Purcell—There are a number of ways in which unsecured creditors adjust for that risk. They either price adjust or effectively diversify their risk in the knowledge that at no particular time all of their debtors are going to go bad. There are arguments around the nature of non-adjusting creditors such as the ATO and employees, who are involuntary creditors by their very nature. But the offset to that type of argument is that the ATO in particular is granted particular powers to ensure that, whilst it is an involuntary creditor, it does receive full satisfaction.

CHAIR—Because the operation of the bill is so much greater than just the tax office—which is what predicated the legislation coming forward—it does seem to me that the bill is in a way trying to take over the role of the marketplace in there being a shared risk between two contracting parties, and that the creditor, via this legislation, seems to be getting almost total protection, in that you can trace the assets as far as you like.

Mr Purcell—And without there having been a discernible intent on the part of the debtor to structure their affairs to give a preference to make a disposition with an intent to avoid.

CHAIR—That is already covered in the act. The existing legislation has that provision.

Mr Purcell—Yes.

CHAIR—Has section 121 been tested other than in the Cummins case?

Mr Purcell—I would have to research that.

CHAIR—Could you do that?

Mr Purcell—Yes, certainly.

CHAIR—In your supplementary submission you specifically say that this section should be redrafted to more closely parallel the scope and operation of the current section 123—protection of certain transfers of property against 'relation back'—which has the objective of lessening the harshness of the clawback provisions. You quote from *Personal and Corporate Law Practice*:

If this doctrine were applied strictly, it would be harsh for people who were involved in dealings with the debtor and who acted in good faith in those dealings. Consequently, the legislation has, in order to mitigate this potential harshness, provided that certain dealings are protected from the effect of the doctrine.

Are you saying that, in relation to the current quarantining provisions in section 123, this new legislation is trying to apply a stricter regime which would quarantine fewer transactions with bona fide third parties?

Mr Purcell—Yes. I would obviously defer to the advice of ITSA and the Attorney-General's Department on this matter, but I think that where the bill interacts with existing provisions in the act needs to be made more clear. There is certainly cross-referencing in the draft bill, with the ideas of non-divisible property—

CHAIR—Superannuation?

Mr Purcell—Yes. On that point, I note that, to adjust for the outcome of Cook v. Benson, there have been proposed amendments to the Bankruptcy Act so that excessive payments of superannuation are not going to be protected and treated as non-divisible property. In making this suggestion around section 139AFB and its cross-referencing to existing section 123, what we are generally trying to encourage is that, if there is persistence in pursuing this type of legislation, more protections than what are currently there can be given to people who deal with the debtor on an arm's-length fair-value basis.

CHAIR—Are you saying that, in the proposed exposure draft, it is too harsh in its application?

Mr Purcell—Yes, absolutely.

CHAIR—And there is not sufficient protection for bona fide third party transactions?

Mr Purcell—Yes.

CHAIR—Thank you very much. When we go through things, there might be things we will want to clarify with you. Thank you for your appearance today.

Mr Purcell—Thank you for the opportunity.

[11.01 a.m.]

PALMER, Mr William James, General Manager, Standards and Public Affairs, Institute of Chartered Accountants in Australia

PASCOE, Mr Scott Darren, Chartered Accountant and Registered Trustee in Bankruptcy, Institute of Chartered Accountants in Australia

CHAIR—Welcome. The committee has received your submission and authorised it for publication. Would you like to make an opening statement?

Mr Palmer—The Institute of Chartered Accountants, which represents some 40,000 accountants employed in both business and professional practice, welcomes the opportunity to appear before the committee and fully supports the policy objectives of the bill as they relate to the issue of high-income professionals using bankruptcy as a means of avoiding their tax obligations. However, in our view and as detailed in our submission, the provisions of the bill have undesirable and unintended consequences that extend way beyond these policy objectives. These unintended consequences could adversely impact on small business, charitable organisations and entrepreneurial activity generally. In addition, we also consider that the retrospective nature of the bill is particularly unfair and contrary to natural justice.

The institute believes that these undesirable and unintended consequences arise through attempting to implement the policy objective exclusively through amendments to the Bankruptcy Act. The report of the joint task force that formed the basis of the bill was concerned exclusively with the issue of avoidance of tax obligations. Consequently, the solution to this problem should also focus on tax. The institute suggests that the problems which have been experienced by the ATO are best addressed by the ATO adopting a much more proactive approach to identifying and pursuing high-income professionals who do not meet their tax obligations, using its existing powers. The ATO can presently access information about potential tax evaders through data-matching exercises with professional associations, such as those currently being undertaken with respect to the accounting profession. We could also amend section 153 of the Bankruptcy Act to allow the ATO to apply to the court for an order that a provable debt to the ATO not be released upon discharge from bankruptcy.

Finally, we could extend the present two- and up to five-year relation back period by one year for every year that a tax obligation is outstanding. For example, if the bankrupt has 10 years of outstanding tax returns, then the time frame for setting aside asset dispositions would be 12 years. At the very least, passage of the bill should be deferred pending much wider consultation with various stakeholders to ensure that the problem is addressed in a comprehensive manner to arrive at a workable solution which avoids the adverse consequences identified by us. Thank you.

CHAIR—Thank you very much. I take it that your suggestion for the clawback period—that is, one year for each year that tax is outstanding—would overcome any possible difficulties the tax office may encounter if it loses the appeal on Cummins.

Mr Palmer—I had not contemplated it directly in relation to the tax office losing its appeal against Cummins, but certainly the gist of that recommendation was to try and provide a suggestion, rather than merely saying we had a problem, and also to try and identify a suggestion that dealt directly with the problem the ATO was alluding to in the task force report.

CHAIR—The amendment to section 153 and the application to the court. Would that part not be discharged, in other words?

Mr Palmer—Correct.

CHAIR—You have also talked about the retrospectivity of the proposed legislation. Would you like to expand upon that?

Mr Palmer—In our view that is particularly unreasonable when you look at the fact that for many years people have been entering into arrangements in the knowledge of what the existing law was. At the time of entering into those arrangements, those people were solvent, they may have had family or other reasons for doing these things, and they will now be in a position where all of that could be exposed and overturned. In our view that creates uncertainty which is not conducive to respect for the law and is contrary to fairness to them, in that they entered into those arrangements at the time when the law was as it was.

Mr SECKER—At the same time, you are prepared under the Bankruptcy Act to go two years further than the number of years for which they have not put in a tax return—that is retrospective action.

Mr Palmer—But in that case we are distinguishing between the people who are the very target of the legislation. In alluding to the fact that it should not be retrospective of a general nature, the act does not refer to tax creditors and talks about other creditors. Our whole case, if you like, is that we believe that they should be focusing on the issue that was identified by the task force, which was in fact the question of unpaid taxes. In that light, we think that, if you were not meeting an obligation that was required at the time—for example, lodging a tax return or paying your tax—a mechanism which would address that issue is reasonable.

Mr SECKER—Because they have already broken the law.

Mr Palmer—They have already done something that was inappropriate. In fact, they have made a situation whereby in trying to resolve that issue there were all these other people who had not broken the law at the time and in good faith went into arrangements.

CHAIR—I want to go to your point about the tainted purposes provisions. Are you aware of any other legislation in any other jurisdiction regarding bankruptcy that has a concept of tainted property?

Mr Palmer—Personally, I am not. Scott may be in a better position to answer.

Mr Pascoe—I am not aware of any either.

CHAIR—Not in the US or in the UK?

Mr Pascoe—I am not an expert on foreign bankruptcy laws, but there are none that I am aware of.

CHAIR—In your statement you put the proposition that the tainted purpose provision of section 139AFA and the section 139AFB exemptions 'have a very wide impact and could elevate the rights of creditors above the expectations of family members, and such a shift in public policy requires much further debate'. Would you like to talk about that a bit more?

Mr Palmer—I think it was mentioned earlier that the gist of a lot of the provisions is that, effectively, creditors will enjoy a protection that is not available to some others, and some of those other people include family members. So our concern was that we have a situation where arrangements that were put in for a variety of other reasons, including provisions of looking after your family and things of that nature, could be set aside by giving a quarantining, effectively, for the benefit of creditors as opposed to others that may have a legitimate interest in the assets of the particular person.

CHAIR—It is an interesting concept to see where you would perhaps have competing interests of legislation—for instance, part VIIIA of the Family Law Act where a settlement is brought about and the intent is to provide for the children. I am not talking about the sort of maintenance agreement where you could enter into such an agreement which would make you technically insolvent. I am not talking about that; the Child Support Agency alone seems to be almost capable of it. I am talking about where someone is making an adequate and reasonable provision for their family on a divorce settlement. That property and that settlement could subsequently be deemed to be tainted simply because it had been involved in the sort of example that I gave where it is being used as the backing-up for a business. You heard the example I gave of the panel beater. Does that case make sense to you—that it is possible it could be something which a trustee in bankruptcy could pursue?

Mr Pascoe—Certainly I think, from the example you gave, that it probably is in doubt. It is certainly uncertain that it would qualify as tainted property. The thing that would perhaps create further uncertainty is that it is a question of the use or benefit. You have got a question of whether or not it is a genuine separation and they are actually living apart, or whether it is a separation of convenience in property only. This is going to put more uncertainty into any recovery that a trustee is trying to make. From a trustee's point of view it is very difficult to tell the difference if appearances are kept up of a separation as distinct from a sham. So certainly it is going to create a lot of uncertainty in a situation such as that.

Mr SECKER—Could it actually encourage people to separate and divorce?

Mr Pascoe—A simple avoidance mechanism would be maintaining a rented property in your name and still living in the home, having your mail sent somewhere else. But I would say that, certainly for those who were planning it, it is an industry that will probably develop.

Mr MURPHY—This submission by Stephen Harrison is a very good submission. Bearing in mind your introductory comments that you support the objectives of the bill as they relate to high-income professionals using bankruptcy as an escape route to avoid paying tax and bearing in mind the conclusions at the end of Mr Harrison's submission—I will not go through them—what would you like this committee to do to make changes to the proposed draft bill? We want

to get the balance right and we do not want to see what happened with the high-income professionals happen with some of the so-called genuine, honest businesspeople that you are seeking to protect, as reflected in your submission. We could water this down too much and it would be business as usual. We do not want to do that either, and neither would you support that. So what do you think we can do to get the balance right?

Mr Palmer—We feel that some of the solutions lie outside the bill that we currently have before us for discussion. In particular, extending the relation back period would mean an amendment to the current provisions of section 120 of the act, but that could be done within that mechanism. We also mentioned earlier the possibility of amendments to section 153, which would mean that the tax debt remains despite bankruptcy, if it has not been discharged. They are two of the suggestions we had of a legislative nature, which would address the issue but not impose the adverse consequences that we have all been discussing. The third thing was that we thought—and to some extent the ATO have even commented on this—that, by being more proactive within the existing powers that are available to them, the ATO have a lot more opportunity to identify these people at an early stage and take remedial action. I know at the moment with the accounting profession they are carrying out a data-matching exercise. We do not have any problems with that. If there are members of our profession who are not lodging their tax returns and other things, then we believe that the tax office have an obligation to do something about that.

Mr MURPHY—We would share that but we would not be confident, in view of the history of the tax office's dealings with members of the legal profession and the many shortcomings that have been identified there. Those people are so prominent in the community, and the sorts of people whom you are trying to protect and whom we would like to protect—people who genuinely arrange their affairs to take reasonable steps to protect their families—might go undetected by the tax office. In other words, if the tax office cannot see the wood for the trees, I am worried about the smaller, genuine businesspeople going about their everyday lives. If the tax office cannot pick up the big fish, how are they going to deal with dishonest small business people?

Mr Palmer—We come back to the argument that a lot of those issues with the tax office can be addressed by them being more proactive within their existing powers. I hear your concern that they had these powers with the barristers but did not really do much, although I gather there is a bit of a timing issue in the sense that a lot of these issues arose prior to them being a lot more proactive, as they are now becoming, with data-matching and other types of exercises. To some extent, I think the ATO are getting on the track after, shall we say, the undesirable experiences we are alluding to with the barristers.

Mr MURPHY—I would submit that they are reactive rather than proactive. We have put so much pressure on them in parliament. Yes, they are responding, and that is good—that is what we want. But it was clear from our interrogation this morning that they did not have answers for how they missed these high flyers. That is what worries us. Everyone agrees that we should be after the high flyers, the dishonest people, but tragically there are also some dishonest small business people that the tax office should be weeding out. I am not that confident, and I know something about this through my attempts to get information out of the tax office over the past couple of years. I would like to think that we could get the balance right. We have come this far—everyone is going in the one direction and wants to do something to stop people employing

bankruptcy in family law to avoid paying tax—and we need to be sure we do not sufficiently water this down so that the status quo prevails.

Mr Palmer—If you have provisions such as the idea that an outstanding tax debt does not pass with bankruptcy then you are bringing in other consequences that, aside from what the tax office can do in a proactive sense, are still helping to address the issue. That is why we went for that three-point solution.

Mr SECKER—The only problem with that argument is that, if the Australian Taxation Office debt never gets wiped off, creditors might say, 'Why are our debts wiped off?' You are still creditors, whether you are the tax office or a normal creditor, are you not?

Mr Palmer—Yes, you are. I must admit our recommendations have essentially targeted the concerns of the task force. We have gone from the logic that the task force, the whole bill and everything else evolved from its report, which was concerned with the area that we are specifically talking about.

Mr SECKER—You are against retrospectivity, which I am philosophically very much opposed to, but you would accept it for two years on top of each year for which people have not lodged a tax form. Does that mean you would accept retrospectivity for asset transfers for two years?

Mr Palmer—In the existing legislation there has always been the provision for two years and up to five years. We felt that struck a reasonable balance between the rights of the creditor and the rights of the other people. The other thing is, apart from the evidence that the ATO has put to the task force regarding recalcitrant high-income professionals, there is no evidence that I am aware of that people have been concerned about systemic problems with the bankruptcy legislation as it impacts the wider community.

Mr SECKER—You say you would be happy with an amendment to the act that said, if someone had not lodged tax forms for 10 years, you could go 10 plus two years and up to five. You would accept that amendment, but you would find it very hard to accept the retrospectivity of 20 years, when people have made arrangements. And that is a fair enough point.

Mr Palmer—Yes.

Mr Pascoe—The other difference from the existing act is that, if there is a relationship of insolvency with the recovery provisions, the exposure draft does not have a link with insolvency. The existing act has a link to insolvency for sections 120 and 121, whereas the proposed act does not have that link. In my view, there is a distinction between actions you do when you cannot pay your debts as they fall due and the things you do when there are no debts on the horizon that are likely to cause this problem.

Mr SECKER—Except if people have been breaking the law by not lodging tax returns.

Mr Pascoe—If people have not been lodging tax returns, they have tax debts that they have not paid, so that relationship to insolvency is there.

Mr Palmer—I think you can make the exception for the ATO also, in looking at the philosophical argument about retrospectivity, in that other creditors are aware of the debt at the time. One of the arguments at the ATO is that they are not aware of who actually earned the income.

Dr WASHER—In your submission, under the heading 'Unintended Consequences of the Bill' you said that it:

... would unfairly result in legitimate arrangements for professionals in business to deal with exposures arising from gaps in professional indemnity insurance cover being ineffective.

That is pretty important to a lot of people out there. Could you flesh that out a little more?

Mr Palmer—One only has to look at the example of HIH to see that people who were insured were not covered in the long run. Even though there were provisions put in for a certain level of cover, there were people who fell outside of that. They were people who were not insolvent, had lodged their tax returns and had done the right thing. A professional negligence case arose. They thought they were insured and found out that, through no fault of their own, they had an exposure. If those people in the course of being in business had made some provision for their families and other things, given the nature and inadequacy of the professional indemnity market, under these provisions any previous arrangements could be overturned and they would all be exposed. Yet nothing those people have done would be considered as undesirable conduct. What has failed them has been the insurance market.

CHAIR—One of the things that is of concern to me is that in the concept of 'tainted property' there is no value placed on love and affection between spouses in the transfer of property. That has been a pretty fundamental tenet of the law for a long time, and yet here it is specifically given no value at all. Indeed, you cannot help wondering whether people could handle their affairs and conduct business if they were not married, that maybe they are advantaged when compared with people who are married. Would you like to comment on that?

Mr Palmer—I do not think that I would go so far as to say it is a disincentive for marriage, but certainly we in our proposal alluded to the fact that a spouse has rights, like anybody else does. The effect of this is that their rights could be, if you like, set aside because of the provisions of the bill. On balance, it does not appear to recognise their existing rights. As to whether that would induce people to make arrangements other than matrimony, I am not in a position to comment further.

Dr WASHER—Can I get you to explain to the committee what power the tax commissioner has? How far can they go back with unpaid tax debts? What is the ruling currently? If people do not submit tax forms for, say, 10 years, how far back can the ATO go?

Mr Pascoe—I am afraid that the tax act is not really my specialty. As far as I know they can go back, if you have not lodged your returns, as far as they like.

Mr MURPHY—Forty-five years.

Mr Palmer—I do not think there is any problem with the distance that they can go back. They were saying, if people had divested their assets, how far can they go back to unlock them to get them to pay their tax.

Dr WASHER—But there is no limitation on that either, is there?

Mr Palmer—In terms of divesting your assets there is, which is really what they are trying to address in this.

Dr WASHER—What is that limitation currently?

Mr Pascoe—Under section 120, which goes to void transfers, it is between two and five years. Section 121 does not have a time limit, but the transaction needs to be done to defeat creditors. It has that insolvency link.

CHAIR—That is the importance of it. The difficulty with this legislation—and a point that Mr Pascoe was making—is that I suppose in a way this is an enhancement or a growth of the concept of section 121. But 121 says that you really have to have the intent to defeat your creditors, whereas in this concept it is deemed that you are transferring assets for that purpose and so the onus of proof instead of being on the trustee is on the person to whom that asset has been transferred. One of the areas where it impacts most is with husbands and wives and families, because businesspeople will put assets in the name of their spouse, effectively to ensure that they are going to have a roof over their head and somewhere to live if, as they go off in business, down the track something goes bad. It is not that they are specifically intending to behave in such a way that they will go bankrupt and they will be okay and can go off again; it is to protect their family and to ensure that they will have somewhere to live. That seems to me to be a desirable thing to do in our community as a public policy matter.

Mr Palmer—Traditionally, we have had things such as limited liability that have been available to some people—

CHAIR—And not others.

Mr Palmer—And others have had to try to compensate for that. That is why in our submission one of the things that we were concerned about is the impact this would have on entrepreneurial activity. It is a disincentive for people to take reasonable risk.

CHAIR—The problem there, too, is that actually establishing a company and putting your assets into it can be an act of tainting the property. That is why I was making the point that it seems all the risk is being transferred onto the person who is the debtor and that the creditors are being absolved of risk, or am I taking that too far?

Mr Pascoe—There is still a risk that no recovery will result, in any event. But certainly it is a changing of the balance, pushing more risk in that direction.

Mr Palmer—Certainly where you have someone who is solvent, maybe through a spouse or someone else, a family member.

CHAIR—Staying with that point, to me, it should be the market that is adjusting that risk question.

Mr Pascoe—Yes.

Mr Palmer—That is why we would say that, under the present arrangement, there has been some recognition of a balance by the two years and the five years and that there is no systemic failure in that arrangement, aside from what this task force addressed, which was the problem the ATO had with a very small number of individuals.

CHAIR—Quite frankly, we did not get any answers as to why the tax office have not picked it up, particularly on the question of their ability to observe the community and see who is living high on the hog and not putting in a tax return. They have the powers to go out and do something about it, by using a betterment tax, but they do not do it and they do not seem to want to do it. Are you aware of whether they do it very often?

Mr Pascoe—I have seen some cases where I have tried to encourage them to assess people who are already bankrupt on a betterment basis and I seem to be unable to get them to do it. I cannot explain why.

CHAIR—I had occasion to force the tax office to do it, and they would not do it then either. I wonder whether we should take a closer look at the way they could use that means. Are you aware of any case, other than the Cummins case, which has tried to use section 121?

Mr Pascoe—Sections 120 and 121 have been litigated over the last 15 or 20 years. Section 121 has been changed three or four times in that period, so not all the cases are relevant, but there are a lot of reported cases on sections 120 and 121. Certainly, trustees' main frustration with section 121 is proving an intention to defeat creditors. It is very hard to get inside a bankrupt's head and prove his intention at the time. I believe the Insolvency Practitioners Association—who are following us this morning—have some suggested amendments to sections 120 and 121 which would perhaps address those things.

CHAIR—Good.

Mr MURPHY—It is pretty obvious, though, in cases like the celebrated activities of some of the high-profile barristers that the only creditor of note was the taxation commissioner.

Mr Pascoe—It is often the case that it is the only creditor.

Mr MURPHY—I think one could reasonably conclude that the transfer of assets to a spouse was done for the sole purpose of tax avoidance and no other purpose. A reasonable person could only conclude that.

Mr Pascoe—I presume—and I am not familiar with the way the Cummins case has been run—that is the argument they have been running in the matter. I have seen all manner of concocted reasons as to why assets were transferred, which apparently have nothing to do with creditors but appear highly suspicious. It does make life fairly difficult to prosecute from a trustee's perspective.

CHAIR—That is why we have courts.

Mr Pascoe—Yes.

CHAIR—It is for them to deliberate and determine on the balance of evidence presented.

Mr Pascoe—Precisely.

CHAIR—Thank you.

[11.34 a.m.]

ARNOLD, Ms Kim Lee-Anne, Technical Director, Insolvency Practitioners Association of Australia

CARTER, Mr Bruce James, President, Insolvency Practitioners Association of Australia

CHAIR—Welcome. The committee has received your submission and authorised it for publication. Would you like to make some opening remarks?

Mr Carter—The Insolvency Practitioners Association of Australia, which I will refer to as the IPAA, welcomes the opportunity to appear this morning and expand upon the submissions it has made. The IPAA is an independent, self-governing organisation that represents professionals who specialise in the field of insolvency. We have over 1,100 full and associate members, including accountants, lawyers, bankers, credit managers, university professors and people from other professions with an interest in insolvency. In effect, we represent the agents that the government expects will enforce the proposed amendments should they become law.

We provide continuing education forums for members by way of discussion groups, conferences and our quarterly magazine. We also consult with regulatory bodies, such as ASIC and ITSA, in the development of standards which our members must follow. For example, in conjunction with ITSA, we released the personal insolvency national standards, which are guidelines on how trustees in bankruptcies should perform. We liaise and work with government bodies such as the ATO and the Department of Employment and Workplace Relations. We are also active contributors to discussions on reforms to Australia's insolvency laws and other insolvency related issues. Recently, we made submissions to Treasury on the issue of the priority of the superannuation guarantee charge, to the ATO on the application of pay-as-you-go to distributions of employee entitlements in insolvency, to the joint parliamentary inquiry on insolvency laws, as well as to this inquiry.

We welcome any legislative amendment that allows trustees to claw back assets for the benefit of creditors in the event of bankruptcy. However, what we want are amendments that are practical, fair, enforceable and, in particular, meet creditor expectations. We do not believe that the proposed amendments meet these criteria. The proposed amendments have been introduced to address situations where high-income earners have used bankruptcy to avoid tax and other known obligations while retaining use of their personal assets. The IPAA do not support a regime that fosters or encourages tax cheats. However, we consider there are more appropriate avenues through which to pursue such behaviour.

Our submission focused on schedule 1 of the bill and highlighted the issues that will face trustees if this legislation is enacted as it stands. Other submissions have highlighted other intended consequences of schedule 1 for professionals, small business owners, directors and many people in the community. In summary, we believe that from a trustee's perspective the following issues will be encountered when trying to enforce the proposed legislation. Firstly, it is already difficult for trustees to obtain funding for investigations in recovery actions, and this issue is not considered. Secondly, there is no time frame prescribed in the proposed amendments,

and this lack of a time frame will impose unrealistic obligations on trustees. Thirdly, there is ambiguity in relation to the matters that the court is to take into account when making an order. Fourthly, strategies to identify and exploit loopholes in the legislation will continue to be developed by those persons whom this legislation is intended to capture. This legislation in our view will only capture the unsophisticated bankrupt, not the bankrupts whom the legislation is intended to penalise.

Fifthly, the retention requirements for books and records do not match with the unlimited period that trustees are required to investigate, thus making trustee investigations even more difficult. For instance, they do not comply with the books and records requirements of the tax act. The extra investigations will increase the cost to the estate, when trustees are already under pressure to contain costs. Lastly, we believe that it will result in an expectation gap for creditors, as creditors anticipate greater returns that we believe are unlikely to eventuate in the majority of administrations due to the increased cost of investigation and the difficulties that will be encountered in identifying and recovering assets.

In relation to the portion of the bill that deals with interaction between family law and bankruptcy law and maintenance agreements and financial agreements, we are concerned that there has been insufficient consideration of the potential issues raised by the proposed amendments due to the focus on the amendments under schedule 1 and the very short time frame that has been allowed for submissions. Equally, the proposed introduction of the supervised account regime requires extensive consideration that time has prohibited, resulting in only a cursory consideration for the purpose of our submission.

We submit to the committee that there are better ways to achieve the objectives without passing the current proposed amendments. If there are deficiencies in the Bankruptcy Act then these deficiencies should be identified with precision and amendments made after proper consultation to specifically rectify those deficiencies. We believe that there are alternatives to the proposed amendments available, such as: the ATO adopting a more proactive approach to the identification and pursuit of non-complying taxpayers along with the strengthening of the current sections 120 and 121; improving the operations of notices under section 139ZQ; and enhancements to division 4A. These types of changes are much more appropriate than the wholesale replacement of division 4A with a completely new regime and allowing creditors to rely on legislation which will only allow recovery of assets at any time in the future by a trustee rather than proactively dealing with the problem prior to bankruptcy.

Alternatively, if the current proposed amendments are to be enacted we have suggested that time frames be incorporated in the legislation. We put forward two alternatives for the imposition of a time frame, one of which is based on years of outstanding tax obligations. Such a method of establishing a time frame is very appropriate if the purpose of the bill is to penalise those bankrupts who have not met their tax obligations. We know that many other submissions have also included suggested amendments to either the existing legislation or the proposed amendments. Some of these suggestions have merit in our view. Notwithstanding these suggestions, we believe that the best approach is a consultative process to properly assess the deficiencies in the Bankruptcy Act and develop a workable solution.

Finally, we would like to raise with the committee a recommendation made by the Parliamentary Joint Committee on Corporations and Financial Services in their recent report, *Corporate insolvency laws: a stocktake*. Recommendation 59 states:

> The Committee recommends that the Government ensure, particularly when contemplating changes to the law, that the two streams of Australia's insolvency laws, personal bankruptcy and corporate insolvency, harmonise where possible.

We submit that if these proposed amendments were to be enacted they would result in a substantial differentiation between personal and corporate insolvency laws. In our submission and at this hearing we are attempting to articulate the views of our members, who represent a wide cross-section of the professional insolvency community and a large percentage of private bankruptcy trustees. We look forward to questions from the committee.

CHAIR—I am interested that your submission, like so many, says that you agree with the stated policy of the legislation. What is your interpretation of what the policy is?

Mr Carter—Our view is that the intention of the legislation is to attack non-complying, high-income, tax evading debtors. The whole thrust of the legislation has gone towards eliminating that sort of practice or, if it cannot eliminate that type of practice, towards causing a great degree of discouragement for that type of practice.

CHAIR—But the law goes much further than that, doesn't it?

Mr Carter—Certainly in its current form it goes further than that.

CHAIR—In your deliberations and in supporting that policy initiative, have you thought of ways in which the legislation could be amended to reflect that purpose and that purpose only?

Mr Carter—Our view is that the current legislation should be put aside and that greater consultation would probably lead us to the amendment of sections 120 and 121 and the introduction of other specific sections dealing with issues like the non-lodgment of tax returns. We think it can be dealt with far more simply than by the scale of the amendments here. It is very important that our position be understood: we welcome anything that claws back assets for creditors. That is what we are there to do; we are there to recover assets for creditors. But we want amendments that are quite practical and can be understood by creditors that will have a chance of providing a certain outcome.

CHAIR—Do you accept, though, the argument I made earlier that the legislation attempts to change the balance—I will accept those terms—of the risk that any creditor takes; that this legislation is meant to lessen the risk that creditors take?

Mr Carter—If there is an assumption that it will lead to a greater recovery of assets, it must follow that it reduces the risk for creditors; but we are concerned that it may not result in extra recoveries.

CHAIR—Let us talk a little about the way many small businesses structure their operations. Very often their assets will lie in a family trust; those assets will then back up various

borrowings and so on for that business to continue. But this legislation will open up those assets and go behind the trust.

Mr Carter—People arrange their business affairs in a variety of ways, some of them via family trusts. Often, when operating through a family trust, the assets of the individual are still exposed by virtue of guarantees provided to creditors. A lot of people trade as partnerships. A lot of small businesses in Australia are sole traders. An example of that would be a retired politician who is now a consultant quite often conducting himself or herself as a sole trader. There are costs and expenses in running a corporate structure. Again I think trustees in bankruptcy see a variety of different ways that the structures apply. Often it is more efficient to run a small situation—for instance, a small family partnership, a farming partnership—as a partnership. Everyone is different.

Mr SECKER—What about family trusts?

Mr Carter—Trusts are quite common and are certainly used as methods not only for putting assets aside for family members but also to deal with situations where there is a large family. Take a farmer: he has four or five children moving their way through life and he does not really know who will take over the farm. He wants to deal with them in an equitable manner, and one of the ways of doing that is through a family trust. Family trusts are also used for dealing with problems in generations: one level of generation may need to be skipped to get down to the next generation. There are a variety of reasons for using trusts; it is not only for asset protection that you would see them being used.

CHAIR—Yet they would all be exposed under this legislation.

Mr Carter—Yes. Under the current legislation, all of that would be attackable. There are provisions already in the Bankruptcy Act for attacking trusts, but these provisions would certainly take that further.

CHAIR—But again the point is made that there is the need to prove that it was for the purpose of defeating creditors, whereas this legislation 'deems' that to be the purpose, doesn't it?

Mr Carter—Yes, that is right. Also you need to have a benefit and 'benefit' is not defined. We do not know what comprises a benefit. A benefit will move from individual to individual, from mind to mind. There will be some obvious definable benefits where someone, for instance, stays in a house.

CHAIR—And initially you as a trustee would have to make a judgment as to whether or not to pursue that case?

Mr Carter—That is correct, and at the moment we do not know which way the courts will take it. It is vague. There are guidelines in there about the types of things that a judge can take into consideration. We expect it will vary from case to case and from judge to judge. A trustee in bankruptcy running a case like this will of course have issues with costs. Running federal court actions are not cheap. They will have cost risks. Creditors generally will not provide funding for these types of things—including the ATO—so what we are concerned about is, for instance, where we have a situation where we are appointed over an individual who has gone bankrupt.

We are expected to go back 20 years to someone who transferred a house to their spouse. There are no books or records. The onus is on the spouse.

CHAIR—To prove it?

Mr Carter—Yes, and they say, 'We did not get a benefit,' and we have to prove that they did get a benefit, and so it goes, on and on.

Mr MURPHY—Has the Insolvency Practitioners Association of Australia ever, in liaising with ITSA, expressed any concern about the ease with which a person can file a debtor's petition with ITSA and very easily become bankrupt?

Mr Carter—I do not have that information here at hand. I am not sure whether we have. Certainly there would have been discussion, because we have active consultation, but as to whether or not we have ever had that firm submission, I do not know. I would expect that there would have been discussion, but I cannot tell you if it was as definitive as that.

Mr MURPHY—I think we would also share the concerns you expressed in your opening submission about the rush with which this legislation has been brought in and in which we are expected to deal with it. That is beyond our control. We ourselves have been swamped with over 100 very detailed submissions, many saying the same things. Do you wish to give us a further submission, in addition to your submission of 17 June? Do you want to have a closer look at the legislation and the unintended consequences and submit anything further to us?

Mr Carter—At this stage I think we should take that on notice. I think it is unlikely, but we would like to take that on notice.

Mr SECKER—Would you like to reserve your rights?

Mr Carter—That is right—reserve our rights.

Mr MURPHY—I just want to make the point, because you may have heard earlier the Institute of Chartered Accountants in Australia say some of the same things that you said. They also concluded that the ATO should be more proactive, and we certainly find, as I said to the Institute of Chartered Accountants, that the tax office were clearly reactive, in light of the barristers' scandal. What would you specifically like the ATO to do?

Mr Carter—We listened to the evidence as well. I think that some of the things that the ATO could be doing have been done. As I understand it, part of the way that the barrister non-lodgment issues came to light was through the ABN and GST registrations, so I think the ATO are alert to these types of things. As to what else they could be doing, perhaps Kim would like to comment.

Ms Arnold—I think it comes down to proactively identifying noncompliance. As both Bruce and the institute said, running systems where they crosscheck membership lists against people who are lodging tax returns is a vital way of doing that, but I think you raised the issue of how they detect a small business in this situation. My understanding is that ABNs are allowing the tax office to be more proactive in that respect. I think legislation that has an unlimited time frame is

not the solution to proactively identifying noncompliance quicker. If you have a legislation that has a time frame, it will achieve the objective, because you are picking up noncompliance quicker. So, if noncompliance is detected—there is not compliance—and they go bankrupt, you can work better within the existing legislation that we have, because they are being detected quicker and it is not 10, 20, 30 or 40 years down the track that the noncompliance is being detected.

CHAIR—You are also saying, presumably, that to have this legislation in place could almost bring about a bit of slackness, if you like, because they know they can always go back, whereas if you have time limits you have to meet the time limits or you have lost your right to go back.

Ms Arnold—I believe that that is the case.

CHAIR—It is quite serious, really.

Ms Arnold—If you have an unlimited piece of legislation, there is no incentive to ensure compliance in a timely manner.

CHAIR—It can go in the too-hard basket and you will think about it several years later.

Ms Arnold—Yes.

CHAIR—One of the things that is of concern to me is that the broad scope in the deeming provisions can make title to property uncertain. Certainty of title is an underpinning tenet of our legal system. To render title uncertain does not seem to be what I would desire in public policy.

Mr Carter—To some extent the preference laws already bring that in. But then you keep coming back to a situation where you have insolvency. Here you can conduct a transaction with someone that is perfectly solvent and then find the right to that title challenged later on. So your view on this is, in my view, correct.

CHAIR—What about a situation where you have had a transfer of, say, a family home—a half-share in the house—where there is no monetary payment? Supposing the person to whom that is transferred—the spouse—dies, the money goes into the estate and it passes to the children. Under this legislation, you could trace it.

Mr Carter—That is correct. So we would be obliged to attack that.

CHAIR—Attack it and go after the children?

Mr Carter—Yes. Another situation is—

CHAIR—Indeed it could be grandchildren—you could go two generations.

Mr Carter—Yes, it can be traced. Indeed, take a situation of a politician who has put their asset in their spouse's name and then in 10 years time, after retiring from politics, has started a business and become bankrupt through no fault of their own—it could be for a variety of reasons; it may have been their fault.

CHAIR—They defamed someone and got sued?

Mr Carter—Yes. Let us say it is in nine years time, you can go back and lose that asset—that asset will be attacked. If that asset has moved down into other generations, certainly it can be traced. The other minefield there is the issue with the Family Law Act. Let us say that within that nine years you have split up with your spouse and the spouse has received the house as part of the settlement and gone off and remarried. We think that that asset can be attacked as well, because you had the benefit of that asset, and we can go and attack it.

CHAIR—So what was the benefit?

Mr Carter—You lived there for a while, so you had a benefit. The term of benefit and when the benefit is derived are unclear. We have just said, 'You have had a benefit.'

CHAIR—Were you here when I gave my example of the panel beater?

Mr Carter—No.

CHAIR—I gave the following example, with a husband and wife. The husband buys the home. He is also conducting a panel beating business. He transfers half the interest in the home to the wife. The home is still used as the basis for providing the capital for the panel beating business. Fifteen years later they get divorced. In the settlement she takes the house—all of it—and he gets the panel beating business. He continues to go on, but business is not too good and five years later he goes bankrupt. Can the trustee come back to that home?

Mr Carter—Certainly the trustee would, under this legislation, come back and attack the home. As to where that goes with the family law principles and the Family Law Court, we do not know.

CHAIR—Precisely.

Mr Carter—Traditionally, it has been a minefield because they are both federal acts.

CHAIR—That is right—so they are competing.

Mr Carter—Yes, so they compete. And, with no disrespect to family law judges, they are not as commercially experienced as, say, Supreme Court judges and Federal Court judges. So some of the experiences that trustees have in the family courts now are somewhat unpredictable because of the greyness between the two acts. This would lead to further confusion, and the example that you gave is a good example; I do not think either of us could predict the outcome—

Ms Arnold—No.

Mr Carter—other than that the creditors would expect us to go back and pursue it.

Mr SECKER—What about a situation where a husband had a pretty big payout to the wife in the Family Court? Not having a lot left after, he might think, 'Well, I'm going to go bankrupt here and my ex-wife won't get anything either'—because she will have to go and pursue it.

Mr Carter—Yes, there certainly would be that opportunity.

Ms Arnold—Potentially.

CHAIR—That is a very interesting point.

Mr SECKER—What was your attitude to the Institute of Chartered Accountants' possible amendment to add two to five years onto, for example, the 10 years for which you had not lodged a tax return?

Mr Carter—As we said in our opening statement, we support that.

Mr SECKER—Okay.

Ms Arnold—But we have to come back to the point that we think there needs to be wider consultation on what the amendments should achieve. There was virtually no consultation with the insolvency community before this legislation was drafted, and we have a lot of concerns about that. We are usually actively involved in the process of law reform, and the legislation was essentially drafted before our members who were involved in the forum had a chance to look at this legislation—

Mr SECKER—That is a fair point.

Ms Arnold—and we are very concerned about that.

CHAIR—Who is driving this legislation, do you think?

Ms Arnold—We understand it is—

Mr Carter—I think all we can do is rely on the statements that have been made, and the explanatory statements appear to have come out of the Australian Taxation Office.

Dr WASHER—Mr Carter, hypothetically, if the tax office were to aggressively take on these people in the legal profession who become insolvent or bankrupt and avoid paying tax, would the current laws be able to address that?

Mr Carter—In some part, but a properly planned bankrupt would be able to defeat them. In fact, it is our submission that even with the new legislation a properly planned bankrupt probably will be able to defeat them as well. It is going to be the less sophisticated bankrupt that cannot—the example of the farmer or the panel beater. The proposed changes are so vague and there will be a variety of instruments to get around the suggested changes. Some of that may be about the way that you deal with your spouse. There are numerous ways it could be done that we have already thought about. But, as it stands, I think for instance the barrister situation in New South Wales has been improved dramatically—

CHAIR—It has.

Mr Carter—by the Law Society improving its guidelines.

CHAIR—The Bar Association. The Law Society was always doing quite well, thank you!

Mr Carter—I beg your pardon; the Bar Association—and I think that if the foundation bodies assist in eliminating these types of behaviours to the extent that they relate to professionals then that helps a lot as well.

Dr WASHER—The impression I personally have been given so far is that we could cause a lot of collateral damage to people who do not really deserve that damage—basically, people who would be fairly naive and innocent in this and could inadvertently go bankrupt. You say here there are loopholes and deficiencies in this bill we are proposing that would not resolve the issue for those who are determined and maliciously set out to defraud, for example, the ATO. Is that a true statement?

Mr Carter—Yes. Our comments really centre upon our role to go out and administer these proposed changes and the current changes, and so we are not commenting on the policy other than to say of course we do not support tax cheats and these types of things. What we are saying to you is that, if you give us these legislative changes, we believe they will not achieve a lot of what you want to see achieved. That is the point that we make. At the moment they are not achieving some of it, but to think that this is a panacea to solve all of these issues is in our view misplaced.

CHAIR—Can I ask you about section 121 and the number of prosecutions under that section. We heard previously from Mr Pascoe that the section has been litigated quite often. In your experience, how successful is it?

Mr Carter—The issue with section 121 is that you have to prove that the debtor was insolvent at the time, and that is what distinguishes it from the proposed changes. There is a variety of litigation under section 121. Changes have been made when it has been shown to be lacking in certain areas, but really every case is different. It is not like a preference section which is regularly litigated; section 121 is around, but it is very hard to show what was in a person's mind when they did a certain type of transaction. First of all you have to prove insolvency, and you also have to prove they were thinking in a certain way. Often insolvency is proved with the benefit of hindsight. To be fair, many people would have had the view that they were just in a downturn in the market and that it would improve, and more often than not they are right. But if it does not improve and they go bankrupt and they are insolvent at the time, it has to go back to the purpose. So you are dealing with, as I think Scott said, what is inside people's minds.

CHAIR—Except, as Mr Murphy pointed out quite rightly with regard to one barrister's case, where the only debt was the tax debt.

Mr Carter—That is a fairly cut and dried situation. If the only debt was the tax debt and the circumstance was that the person was earning a large income, that is a very much easier scenario to prove. I am dealing with your regular type of bankrupt—the panel beater example that you used.

Ms Arnold—I would like to add too that it is often difficult to know how successful sections are, because there are a lot of settlements made by trustees outside the court situation. So it can

be difficult to tell exactly how successful a section has been, because of those out-of-court settlements that may have occurred.

CHAIR—If it is bringing about a lot of settlements then it is being very successful.

Ms Arnold—That is right.

CHAIR—We all know that the vast majority of the cases that begin are settled. If they were not, the courts could never cope.

Ms Arnold—But it is very difficult then to tell how successful it has been, because it is anecdotal evidence from trustees.

CHAIR—Yes, but once you set a precedent and it becomes established you can say it is successful. Thank you very much. We are very grateful to you, particularly for the point you made that, as practitioners in insolvency, you were only consulted after the legislation had been drafted and not before.

Mr Carter—Yes, that is correct.

Ms Arnold—Paul Cook, who is on our committee, is a member of the forum that meets on bankruptcy issues. They met to discuss this, and it is my understanding from him that the consultation was such that they were given copies of the proposed legislation to consider and it was discussed at those forums.

Mr Carter—And then taken back.

Ms Arnold—And the draft legislation was taken back from them. They could not take it from the forum to discuss it more widely within our professional body.

CHAIR—I am aware that, in the course of what you have described there, Mr Cook has expressed his concern that the suggested changes could be anti-family and anti-marriage, in that—whereas a marriage may be rectified and the partners may get back together again, with appropriate counselling—if one partner is given advice that by staying together they could jeopardise a later asset split, that may prematurely determine the marriage. Thank you for coming this morning. We thank you for your evidence.

Is it the wish of the committee that submissions Nos 103 to 118 be accepted as submissions and authorised for publication and that supplementary submission No. 2.2, from Cleary Hoare Solicitors, be accepted into the inquiry and authorised for publication? There being no objection, it is so ordered.

Proceedings suspended from 12.10 p.m. to 2.17 p.m.

CLARKE, Ms Beverley Anne, Executive Director, Professions Australia

JOHNSON, Miss Linda Ellen, External Consultant, Mallesons Stephen Jaques, Professions Australia

CHAIR—Welcome. We have received your submission and authorised it for publication. Would you like to make an opening statement?

Ms Clarke—Thank you for the opportunity to appear before the committee. Professions Australia represents 21 professional associations and over 300,000 professionals Australia wide. Professions Australia supports the objective of the proposed legislation: that is, to prevent high net worth individuals from using bankruptcy and family law schemes to avoid payment of tax. However, in seeking to achieve this goal, the bill proposes amendments which apply indiscriminately with unintended consequences for all individuals and business.

It is the view of Professions Australia that the far-reaching amendments as currently proposed should not be enacted. Our specific concerns with the bill are detailed in our submission. Today we would like to take the opportunity in our opening statement to focus on some possible solutions. By relying solely on amendments to the Bankruptcy Act to address the inability of one creditor—the ATO—to undertake effective recovery action against tax evaders or recalcitrant debtors, the bill effectively cracks a nut with a sledgehammer.

Professions Australia is proposing that the problem be addressed by a broader four-point solution. Firstly, we propose amendments to the Bankruptcy Act to allow greater and earlier access to the courts by all creditors, including the ATO—for example, to institute a statutory demand procedure which, if not complied with, triggers an act of bankruptcy. This would apply to all creditors, not just the ATO. Secondly, we propose amendments to the tax act to increase the penalties associated with deliberate tax evasion and increase the non-discharge period in a bankruptcy where serious tax evasion has been engaged in. Thirdly, we propose increasing the priority and the resources that the ATO and the trustees in bankruptcy can and do devote to this area. Fourthly, we propose strict application by the Bar Association of its legal right to suspend or cancel a barrister's practising certificate if they are engaged in conduct to avoid tax. It is our understanding that, since the introduction of amendments to the NSW Legal Profession Act, 23 barristers have been struck off. This should also apply to other professions, whether via legal rights or membership obligations.

There are also a number of existing tax powers which we believe have been underutilised by the ATO. The ATO can access much information about a potential tax avoider through a number of mechanisms, including the cash transaction and other reporting obligations of financial institutions, the requirement to have an ABN to obtain any tax benefit, crosschecking individual partner tax returns against partnership tax returns and crosschecking member tax returns against listed professionals. For example, last year the ATO obtained lists of registered members from architect, Law Society and accounting associations in Australia. The ATO can also liaise with other professional associations.

Once potential avoiders are identified, the ATO also has broad-reaching powers not available to other creditors. It has the power to issue default assessments or amended assessments on an assets betterment basis, where an individual has not lodged a tax return or where the ATO believes the taxable income should be higher. It can issue the equivalent of garnishee orders, requiring third parties to pay money to the ATO, instead of the individual who has not paid their tax. The ATO can also access books and other evidence and information from third parties who may have information about an individual taxpayer. To date, the ATO has not been proactive in using these powers. It is our view that, by making full use of its existing powers, in conjunction with the solutions we have proposed, the ATO could speed up the recovery process and help avoid the issues identified in the task force report.

CHAIR—Thank you for your submission. We notice that you have also let us have a list of several alternative solutions which you think could be applicable. I was particularly interested that you mentioned in your submission the use of the betterment tax provisions. I am at a loss to know why the commissioner does not use them more. To my way of thinking, they would have been a very fine way of dealing with those barristers, for instance. Would you like to expand on those provisions and the use of those provisions?

Miss Johnson—We agree with that view. They have been underused. They appear to give the tax office quite sufficient power to effectively impose an assessment based on a person's asset position or the equivalent provider of that service's income. Effectively, as I understand them, they reverse the onus. Once the assessment has actually been issued, it is up to the taxpayer to show that the assessment was wrongly issued. To me, that should be an adequate way of addressing the problem of those people who do not lodge tax returns or underestimate their taxable income. It goes beyond just simply issuing a regular assessment. They also have the power, for example, to issue a daily assessment. They could go out to any particular business and say, 'We're going to assess for a day. This is the amount of tax that you should pay on the income that you've earned for a day.' So their powers are quite broad. With the reversal of onus, they are in the wonderfully unique position, unlike any other creditor, of being able to use those powers, together with their information-gathering powers, to identify the taxpayer earlier.

CHAIR—The other thing is that this legislation started out as a way of getting at high-income, wealth-producing tax defaulters, yet the legislation is far broader than that. It does capture my example of the person who has got the panel beating firm. What happened in the process? Were you consulted along the way? Were you part of the consultation mechanism?

Ms Clarke—No, we were not.

CHAIR—When did you first become aware of the legislation?

Ms Clarke—Probably about three weeks ago.

CHAIR—When it started to get public.

Ms Clarke—Yes, when it became public.

CHAIR—Normally, would you have expected to be consulted and to have been part of that?

Ms Clarke—Yes. Given that it focuses on professionals and we represent so many professional groups, I would have thought we would have been consulted.

Mr MURPHY—I would like to come in on that. Ms Clarke, you made the point that this should apply to other provisions to be struck off because the origins of this derive from the misconduct of barristers using family law and bankruptcy to avoid paying tax. I do not know whether you are aware that, according to the taxation commissioner, section 16 of the Income Tax Assessment Act prohibits him from advising a peak professional body like the AMA, for example, as opposed to the Law Society or the Society of Accountants or someone else, with regard to the fact that some of these non-taxpayers have not only not paid tax but also been bankrupt on a number of occasions. The taxation commissioner has taken the view that he can not advise these peak professional bodies and the serial offenders have continued to do what they have done and have not paid any tax. I am interested in your submission, being from a professional association, which said that this ought to be extended. As I said earlier this morning to the Taxation Office representatives, I am not on a witch-hunt for members of the legal profession, but I would like to know how this might apply to others. I mention as an example medical practitioners because I do not believe it is the exclusive province of the legal profession that they are using family law and bankruptcy to avoid paying their tax. I support your submission.

CHAIR—I want to go to these solution points that you have put forward. You suggest amendments to the Bankruptcy Act to allow greater and earlier access to the courts by all creditors, including the ATO—for example, instituting a statutory demand procedure, which if not complied with then triggers an act of bankruptcy in itself to apply to all creditors, not just the ATO. My first question about that is: do you mean that you want people to go to court before an act of bankruptcy is committed?

Miss Johnson—No. It seems to us that part of the problem is that creditors or, in this case, the Australian Taxation Office are not getting to the bankruptcy stage quick enough to be able to attack the transactions which they wish to attack, so we were looking for a solution which would speed up the recovery procedure. One solution that is available in a corporate context is that, if you issue what is called a statutory demand, it creates a presumption of insolvency which enables the relevant creditor to then apply to the court to place that company in liquidation. You could introduce that same concept in an individual context so that the act of bankruptcy is created by the failure to comply with the statutory demand, bearing in mind that that comes with a whole bunch of law around it—namely, the right to set aside the demand if it was inappropriately issued such as where there are disputes or set-offs. The idea is that, instead of having to go to court to get a judgement and then issuing a bankruptcy notice before you get an act of bankruptcy—unless you rely on one of the other areas—as is currently required under the existing legislation, we speed up that procedure a little.

CHAIR—I do not know that the tax office's problem was lack of time. They took 45 years in one case. I would have thought that was more than enough time for anyone.

Miss Johnson—We all agree that the Australian Taxation Office needed to employ far more resources and, if they used their existing powers, they would have got the problem people a lot earlier.

CHAIR—Presumably, they should have a task force within the tax office itself whose job it is to be on the look-out for people of high wealth to see if they are filing a return and what it is. I would not have thought that was genius-type thinking.

Mr MURPHY—It is fundamental.

CHAIR—I would have thought so, and I just do not understand why they have not had it. I think we did not get any answers on that from the tax office this morning. Your second point concerns amendments to the tax act to increase penalties associated with deliberate tax evasion and an increase in the non-discharge period in a bankruptcy where serious tax evasion has been engaged in. One of the other suggestions we received today was that, where a tax debt remains outstanding, a bankrupt could be discharged, but leaving the tax debt still to be repaid. That would seem to sit in the same sort of category. Do you have a comment about that?

Miss Johnson—Not quite. I think that the tax office gave away a lot of its priority positions in 1992 when amendments were made, and if you have a concept which introduces that, where there is a tax debt, you have extended clawbacks, or extended periods—or even that tax debt survives bankruptcy—then you actually discourage the little person who quite innocently may have gone into bankruptcy with a tax debt. It is a rare circumstance for the tax commissioner not to be a creditor, because a person does not happen to go bankrupt just after they have paid their tax debt. If that is the case, it is most likely that the payment of the tax debt is going to be a preference, so it will be clawed back. I do not think the solution is giving the tax commissioner a priority or a penalty provision which enables the person to effectively have to bear the tax debt for the rest of their life, especially if the person has gone bankrupt due to unfortunate circumstances and not due to deception, fraud or evasion.

CHAIR—For the last little while we have been in a period of strong economic growth and strong economic conditions. With the position we were in in 1989-90, where we had a serious recession, we had a huge number of bankruptcies. Do you think this has been considered in a time when bankruptcy is not as prevalent as it can be? Do you think enough consideration has been given to what happens when there is a downturn in the economy and you suddenly have a great rash of bankruptcies?

Ms Clarke—I suspect that is right. If you look at the likely impact on small business in those circumstances, it can be quite drastic.

Mr MURPHY—Can I come in at this point, because you did make a political point.

CHAIR—Which one?

Mr MURPHY—That bankruptcies in 1989 and 1990 were high. There was a threefold increase in bankruptcies from 1989-90 to 1999-2000. I am not sure what point you were making, but I want to make the point that bankruptcies have increased and, moreover, there has been a sharp increase in debt agreements following bankruptcy. Getting back to the point that I made earlier in relation to supporting the submission, I am not sure whether Professions Australia is aware of the provisions of section 16 or the way they are interpreted by the taxation commissioner. They cannot advise the peak professional bodies. We all know that when someone goes bankrupt it is out there in the public domain—everyone knows about it—and it is

an absolute bloody nonsense that the taxation commissioner cannot write to the Law Society, which is where it all started, or the AMA or the Bar Association and make the point that one of their members has been bankrupt or is a serial bankrupt. But for that, people like Stephen Archer QC, who made going bankrupt into an art form, would not have been allowed to do what he did for over 20 years—along with the other barristers that I mentioned earlier this morning. Are you aware of the secrecy provisions of section 16 of the Income Tax Assessment Act?

Ms Clarke—I am not personally aware of them.

Miss Johnson—We have read the material that was filed in the task force report and the interpretation that was placed on section 16. You are right: as bankruptcy is a public regime, you would think they would be able to disclose that.

CHAIR—Absolutely.

Miss Johnson—But the other side of it is that they have the power to obtain the information they need before you get to the bankruptcy stage. So they do not have to wait until bankruptcy; they have extreme powers and they should be utilising them.

Mr MURPHY—We asked a lot of questions this morning of the tax office, and other people who have appeared here before us this morning have suggested that the tax office needs to be proactive. We have the tax office coming back to us at a later date because of what has happened in the past, so we will wait.

Dr WASHER—I thank you for some solutions to the problems, Ms Clarke and Miss Johnson. I think they are good. Section 2 gives me a slight headache, too. As you know, product ruling is a fairly new thing for the tax office to be offering people, particularly in professional areas where they earn big money and they want to minimise tax, which is quite legitimate. Sometimes they are advised badly and, historically, they do not always get the best answers from the tax office. Section 2 gives me some anxieties. In Western Australia, where I come from, tax effective schemes seem to blossom, and I do not condone that totally. I think there are genuine people who are caught up believing that they are participating in genuine business and, because of a lack of product ruling or extrapolation of that, section 2 or your No. 2 solution could cause some terrible grief to people who we would like to see get up and be productive in the community. I would like some comments back on that.

Miss Johnson—I think section 2 was not so much to do with the innocent person who went bankrupt or innocently acted on poor advice—which is what I think you are concerned with. If the tax office is concerned about discouraging tax evasion then you need to look at the tax act and whether the penalties are sufficiently severe to discourage tax evasion—that is, wrongful, unlawful acts—rather than at the innocent person who perhaps acted on poor advice. The other aspect of section 2 was the non-discharge period being extended. We just said, 'If you're telling us that the existing penalties in the tax act aren't wide enough and you need to do something to the Bankruptcy Act, then at least extending the non-discharge period means that the trustee has greater control over looking at that person's income for another period.' That is all we were looking at. We were not focusing on the innocent person in terms of tax; we were focusing on a person who effectively had engaged in serious tax evasion.

Dr WASHER—If you flesh that out, my impression—and it is only an impression—is that the tax office, historically, selects soft targets to hit rather than hard targets, and I guess that is human nature and certainly the nature of the tax office as perceived by me. If you are a soft target—sometimes you just get duped in this—is there a protection in this recommendation for someone who genuinely believes that they are in a system where they have defrauded the tax office as proven in law but not intentionally? It is hard for the tax people to judge that. They would take you to court. They are pretty ruthless on this: they take a precedent, they pick a case and they then extrapolate that across.

Miss Johnson—From the outset, we agree that, firstly, the existing process should be the one that is utilised. This suggestion is really only to be used where there has been serious fraud. So you would have to put protections in there in terms of defences for those people who fall into the category that you are talking about.

Dr WASHER—Thank you.

CHAIR—I would just like to talk about the jump. This started out as being legislation to catch high-income earners who avoid paying tax. Suddenly, we are hitting mums and dads and little firms and the whole gamut. What do you think happened in the interim? How come we jumped from one policy statement, where a problem is identified, to this great catch-all?

Ms Clarke—I am not sure we can answer that, having not been involved in any consultation process and having not seen the move from where it started to where it is.

CHAIR—It seems a bit like long-line fishing, doesn't it?

Ms Clarke—Yes.

CHAIR—It catches the turtles and the dolphins and all those things we do not really want to catch.

Mr MURPHY—Ms Clarke and Miss Johnson, how do you think we can get the balance right? We want to do something about those people who seriously attacked the integrity of our taxation system by using so-called legitimate tools—bankruptcy and family law provisions—to avoid paying tax. Whilst we do not want to crucify the genuine small business person, the sole trader, for going bankrupt due to the economic circumstances of the time or incompetence or whatever, how can we get the balance right and avoid the so-called unintended consequences that everyone is telling us about today and in their submissions—we have over 100—so that we make sure it is not business as usual after this inquiry is completed and the so-called proposed amendments are not watered down and nothing has changed, because that would offend most reasonable people?

Ms Clarke—There is an issue about drawing a balance between what the problem used to be and what the problem is now. I understand that some progress has been made in addressing the issue with barristers—the penalty of disbarment et cetera has obviously had an effect, and not being able to earn an income is a pretty useful tool to change people's behaviour. Obviously, the ATO are putting in more resources. We have put the emphasis in our submission on using existing underutilised powers. That does not totally answer your question, if you are looking for

something additional. That is why we focused on recommendations 1 and 2 as the additional ones we gave you—as maybe another way of approaching the problem. We are saying that, using existing mechanisms and giving it some sort of priority, there seem to be the tools there to deal with the problem.

Mr MURPHY—Are you expecting the taxation commissioner to do more than he has done in the past?

Ms Clarke—Working with professional associations and getting lists of names of members and doing all that crosschecking has proved to be quite effective. Certainly, more of that, where there is found to be a problem. seems to be yielding results.

CHAIR—I would like to go back to your submission—the one you sent to us originally. You made several points. You said that this legislation would be in conflict with the Torrens title system. I guess that is because it makes title uncertain. Is that the point you are getting at there?

Miss Johnson—Yes. It does. There is supposed to be indefeasibility under the Torrens system, and under this proposed legislation we can attack far more transactions and quite innocent third parties can be affected.

CHAIR—You say that it is unconstitutional and represents an acquisition of property on unjust terms. There is an argument that has been put around that says it is not, because it comes within the bankruptcy power—under section 51. Would you like to expand on why you think it could be said to be an acquisition of property?

Miss Johnson—In each of the cases under the proposed legislation there is the ability to effectively revest property to the trustee in bankruptcy. Under the existing legislation, where a revesting occurs, there is an obligation on the trustee to pay back consideration that was paid for that property. That is what it does. For example, under 120 and 121, which are the main current provisions that attack transactions intended to defeat creditors, if consideration is paid, the trustee has to pay back that consideration. The proposed legislation does not oblige the court to order that. The court simply has discretion to work out what would be the appropriate vesting order. In fact, no consideration could flow back. So you could be in a unique situation where you paid full market value for property and the court orders the vesting back for no consideration. That is the unjustness of the terms. I appreciate that there is the argument that this is an incidental power in relation to bankruptcy and therefore falls under the constitutional power there, but you really need to look at the provisions associated with unjust acquisitions.

CHAIR—Suppose we take your example: that is, they paid at least market value and it took place less than 10 years before—if it is more than 10 years it is exempt anyway. Supposing it is less than, without just compensation?

Miss Johnson—In those circumstances it is not an exempt transfer under the proposed legislation. It really just depends on the court looking up that shopping list of discretionary factors that it is supposed to look at and making a decision on it. That example that I have just given you is also made harsher because of the reversal of the onus. Those two things together can result in an extremely unjust outcome.

CHAIR—What you are arguing is that it is not a proper use of the incidental power to the bankruptcy placitum. It is in fact falling foul of subsection 57, is it?

Miss Johnson—I forget the subsection. Yes; in some circumstances it can result in little regard having been given to the consideration that was paid, and a person can lose property without getting due and proper consideration for it—particularly if you are not involved in the tainted scheme or the tainted property, because you could be the innocent party but the bankrupt can have the tainted purpose. The result is, 'I have lost because of the presumption that the bankrupt had the tainted purpose. I actually paid market consideration. And I am stuck.'

CHAIR—Do you have a problem with the concept of tainted property in the bankruptcy context?

Miss Johnson—We do have a problem with the way it is currently drafted, yes. The existing legislation already has a concept of property coming back that is involved in what I would loosely describe as tainted transactions. In this particular case it is possible that tainted property can capture property which would not have been available in the bankruptcy of the individual. One of the examples that we had given in our submission was where a husband and wife, for example, pool their assets into a family trust. The wife puts her assets into the family trust—the wife is not the worker in this particular case—and in these circumstances they use that property as the family home. Because the family trust scheme might be seen as a tainted scheme, the wife's property could become available to the husband in the husband's bankruptcy even though had you unwound everything and gone back to the way it was that would not have been property that would have been available to the bankrupt at all. So it actually does capture things which it probably should not have caught in the first place.

CHAIR—It has got the double whammy, hasn't it? Firstly, you are facing that possibility of heaven only knows when you get married what on earth lies down the track, and you deal with your assets. Secondly, with the obligation on the trustee to intervene to go to court, the mere cost of having to try and fight such a case is probably going to result in a settlement somewhere along the line where that person could lose those assets.

Miss Johnson—That is correct. It is also faced with the fact that, unfortunately, the trustee does not have the onus of proof of establishing it did have an improper purpose to begin with.

CHAIR—Do you see there is a difference between the concept of a tainted transaction, which can then have a flow-on effect to property, and tainted property, which is a deemed status under this provision?

Miss Johnson—Yes, I see what you are saying. There is no doubt that the current legislation is drafted in such a way that the tainted property deemed status would capture far many more things than would have been available in a normal situation if the transaction was unwound, regardless of the purpose for which it was entered into. That is part of the problem.

CHAIR—It is quite an important statement, isn't it? This actually makes more property available, some of which ought not be available.

Miss Johnson—That is right. If you look at the current legislation, leaving aside the onus issue, one of the elements that needs to be established is that the property would have fallen into the bankrupt's estate if this transaction had not been entered into—I am talking about section 121. In this particular case, under this proposed legislation, the legislation assumes that it would have been the bankrupt's property. You just simply work out whether it would have been divisible or indivisible property; but it assumes that it is in the bankrupt's estate, so by definition it will capture things that it should not have caught.

CHAIR—What happens if you are going back and trying to unscramble eggs? For example, you could have had a death, and then the estate was passed on and then sold. What is the position, as you see it, of that arm's-length third-party sale? Suppose it is passed to the spouse of the bankrupt, and the bankrupt did not provide full consideration for his spouse's interests—let us presume it is the wife in this case—and then she on-sells the property prior to the bankruptcy? Under this legislation, as I understand it, you can trace it through the sale. So who has to wear the loss?

Miss Johnson—Who wears the loss is left to the discretion of the court.

CHAIR—Then it has been put in the same class as stolen goods.

Miss Johnson—Possibly. You may not catch—

CHAIR—If you buy a stolen vehicle, you cannot get title, can you?

Miss Johnson—I will not go into the rules of nemo dat, but you are right—generally speaking you do not get any better title than the person before you had. The proposed legislation first concentrates on the asset still being retained by the relevant recipient rather than being passed on. It sort of does have, however, some far-reaching consequences where there are particularly tainted schemes involved, I think. I have not looked at the exact circumstance that you have given, but I have looked at something similar. There are three parties involved, and one person pays an arm's-length price, but the first part of the transaction is undersold. A sells to B for nothing, so it is undervalued. B sells to C for full value. If this is considered to be part of a tainted scheme, you can attack both B and C.

CHAIR—Does it have to be part of a scheme for it to be tainted?

Miss Johnson—I have not looked at that. I was just commenting on the example that you have given.

CHAIR—It is a very important question.

Mr MURPHY—Ms Clarke, I am interested in the conclusion of your submission, 'Policy objectives may be achieved by alternative means' to this legislation. Your first point is:

> (a) to increase the resources available to the ATO so that it may pursue effectively persons engaging in tax avoidance;

Then you go on:

(b) to increase the efficiency of debt collection procedures by the ATO so that it may recover unpaid debt tax cheaply and quickly.

… … …

(c) to increase the collection and cross referencing of information available to the ATO ...

(d) to liaise with professional associations to devise other methods of monitoring the lodgment of income tax returns by individual professionals ...

And it goes on. Are you putting to us that we need to massively increase the staff of the Australian Taxation Office to monitor the tax avoidance industry?

Ms Clarke—No. The ATO has a lot of staff, and it is a question of what they give priority to and when they give it priority. My understanding is that as time lapses this problem becomes more difficult. If you take action early on then maybe some of these issues can be more readily addressed. The ATO has to set its own priorities within the resources it is given. There are lots of mechanisms at its disposal which, I understand, in the past they have not been using effectively.

Mr MURPHY—What are they?

Ms Clarke—Like talking to professional associations and getting lists of members and doing that sort of cross-referencing. For example, barristers cannot now practise if they have been found to be avoiding tax. I understand that, since that has been happening, that has had quite a significant impact.

CHAIR—The tax office said this morning that they all paid up.

Mr MURPHY—Yes, but there is the trouble. We were given some vague explanation—unsatisfactory, I might add—as to why the Taxation Commissioner could not advise a peak professional body of the conduct of some taxpayers. That is, they were serial bankrupts, which is a nonsense.

Ms Clarke—I understand that if you are a bankrupt then it is public information.

Mr MURPHY—Exactly.

Ms Clarke—But the other side of it is that there is a deterrent effect. You cannot be a CPA registered accountant et cetera once you have been found to be avoiding tax.

CHAIR—I suspect the real answer was that it lay in the too-hard basket for too long.

Ms Clarke—I suspect so. Perhaps they were not aware of some of the mechanisms that they can use, like associations having lists of registered members.

Mr MURPHY—No-one has made more noise in the federal parliament on this issue than me. Now that the government have done something about it—and I will give them a tick for responding to it—they have produced a sledgehammer to crack a nut. How are we going to get the balance right so that the innocent people who the bankruptcy laws operate to protect do not suffer?

Ms Clarke—That is what we have attempted to do in the solutions we have put on the table—that is, really focus on the mechanisms that are at hand. The tax office should be able to explain how the situation has changed since they have been doing this. Maybe some of the solutions they have put forward in the bankruptcy area have come some time after the event. Hasn't there been some water under the bridge since—

Mr MURPHY—We like to think they would be able to explain, but clearly this morning they were not able to explain. They are going to go away and take on notice some of the questions we raised here this morning and perhaps we will have a better understanding the next time we meet.

Miss Johnson—Your question, however, is on the assumption that a change is needed.

Mr MURPHY—This suggests that there is not such a need.

Miss Johnson—The reality of it is that there has been no case put by the tax office or anybody else that the existing legislation is inadequate. That is the first step.

Mr MURPHY—Precisely.

Miss Johnson—Or that their powers are insufficient. All that is required is for them to use the legislation they have adequately and use their existing powers adequately and they will achieve the objective that they wish to achieve as set out in the task force report. Effectively, I guess what we are looking at is the tax office needing to be more efficient about using the powers and the resources that they have.

Mr MURPHY—We would like to think so.

Miss Johnson—Every other creditor has to collect their debts and they do not have all the powers that the tax office has to do that.

CHAIR—That is right.

Dr WASHER—Just to reinforce that, in Professions Australia's solutions, there is no need for any changes in the act whatsoever—just a greater determination to enforce the act and make it bite harder. I am delighted to see that; I think it is probably right.

I have a problem with paragraph 4(2). I know I am standing by the victim; I do not dislike the tax office and I can understand their need. Western Australia is particularly innovative. As you know, in Western Australia we always seem to have the major problems. Paragraph 4 says, 'Strict application by the Bar Association of its legal right to suspend or cancel a barrister's practising certificate'. That has worked and it has been great. I have a problem with applying a carte blanche formula, even though it has some appeal, because it hits only professional people. The problem with professional people—and forget that part of the legal profession who were blatantly avoiding paying tax by their actions, hence creating the need for this so-called new legislation—is that a lot of people in professions get advice from accountants, lawyers, tax advisers et cetera and can get caught in a situation of bankruptcy, and by definition they would be conducting the business of avoiding tax. To take away their professional licence under those circumstances other than for short times would be unjust in my opinion—compared to, say, my

great friend Alan Bond, who was an innovator without a profession but who probably defrauded the tax office 10,000 times more badly than all these lawyers combined—and a whole heap of other people too.

So the issue is punishing them by just taking away their professional licence. There are good innovators—I do not want to stop innovation, do not misinterpret me; that is the last thing I want to do—but there are people without professions who defraud the system, and I cannot see how the heck we are going to punish them with paragraph 4. All it means is that if I have a profession I get punished and they do not. It is not a just system.

Ms Clarke—I guess the intent of this legislation was to deal with high-income earning professions.

CHAIR—But it does not do that.

Dr WASHER—What we are worried about is that it is cleaning up a lot more dudes than we anticipated.

Miss Johnson—In answer to your question though: it just simply means that the tax office would have to use their existing powers to get the individual who is outside a profession. It might mean accessing their name through a bank or something else—rather than through a professional association—through the tax office's cash transaction reporting legislation. It would mean identifying the individual in that way, but, again, it is an existing power and it is existing legislation.

Dr WASHER—Absolutely. So what you are saying here is that there is a need to identify these people who are offenders in the system, who are obviously entrenched and who are transparently breaching our tax laws?

Miss Johnson—Section 4 is designed for identification so that you can then use the existing powers, yes.

Dr WASHER—That is what I wanted to clarify. Thank you.

CHAIR—I wanted to go back to something you also said in your submission, that it would create uncertainty in business and commercial practices and that it would impact adversely on lending practices, saying that banks will:

... refuse to provide credit facilities unless borrowers can demonstrate that security is not tainted property ...

Would you like to comment on those two points.

Ms Clarke—That is just a general concern and the question could be put to the banks themselves. But just thinking through the issue logically, the whole issue of uncertainty must impact on how creditors feel about lending money and the risks attached to that. That may feed through to the cost of borrowing, which will again impact on professionals trying to grow their businesses and on small businesses borrowing to grow their businesses. So it was just about the whole issue of uncertainty and the impact that it has.

CHAIR—This legislation does not impact on secured creditors, and yet it must indirectly. But the intent is not to.

Miss Johnson—I think the Australian Bankers Association will probably cover that in their submission later today.

CHAIR—We will talk to them about it. We have received a letter from the Insolvency and Trustee Service Australia, signed by Mr Terry Gallagher. Would somebody please move that that submission to be accepted and authorised for publication.

Mr MURPHY—I move that that submission to be accepted and authorised for publication.

CHAIR—There being no objection, it is so ordered. It has quite an interesting example. It says:

The provisions describing 'tainted property' and 'tainted money' merely bring such property or money within the scope of the potential application of the Court.

That is not quite true, because there is a presumption that it is tainted, as I understand it. It goes on:

Where the trustee decides to bring this application, the Court will be required to consider a range of factors relevant to current ownership and value of the property. These factors include:

the extent to which the current value of the property reflects contributions (both financial and non-financial) made by the bankrupt and any other entity (including the owner);

the extent to which both the bankrupt and the owner used or derived a benefit from the property; and

the nature and extent of any estate or interest that any other person or entity has in the property and any hardship that the order might cause that other person or entity.

These considerations are designed to allow the trustee to recover only that part of the property or money which is properly attributable to the bankrupt and to protect the interest of the non bankrupt owner. For example, where the trustee is seeking to recover part of the matrimonial home (which is owned entirely by the non-bankrupt spouse), the Court will have to consider the extent to which the current value of that home reflects the financial and non-contributions made by the non-bankrupt spouse.

What that says to me is that the matrimonial home then becomes automatically less secure in terms of who has title to it. Whether that is the result of a divorce or it is the result of a transfer years in the past—the sort of example I gave in my panel beating case—that seems to me to put an enormous pressure on an innocent spouse and, presumably, the kids who live in the house with her. Have you looked specifically at the nexus between the Family Law Act and the bankruptcy provisions as they are proposed?

Miss Johnson—No. We did not actually have time to do the comparison with the Family Law Act. As Bev indicated, we did not get notice until relatively late in the piece in the consultation

process. The family law interaction stuff was quite complex, so we have not really examined that very much.

CHAIR—What I said to the tax office this morning was that we would not take evidence from them this morning as to the interaction with the Family Law Act and that we would have them back on another occasion to do that. I am wondering whether or not you might like to put your mind to that side of it as well and come back to us with another submission. You could talk to us on that occasion.

Ms Clarke—We would be happy to do that.

CHAIR—Thank you very much for coming before us. If you do not mind taking on that extra workload, that would be great.

[3.05 p.m.]

RAMBALDI, Mr Gess, Partner, Business Recovery and Insolvency Services Division, Pitcher Partners

YEO, Mr Andrew Reginald, Partner, Business Recovery and Insolvency Services Division, Pitcher Partners

CHAIR—Welcome. We have received your submission, which we have in fact published. Would you like to make an opening statement?

Mr Rambaldi—We would, thank you, Madam Chair. Firstly, we would like to thank everyone for the opportunity to present to the House of Representatives Standing Committee on Legal and Constitutional Affairs. By way of introduction, my name is Gess Rambaldi. I am the partner in charge of the Business Recovery and Insolvency Services Division of Pitcher Partners in Melbourne. With me is my fellow insolvency partner Andrew Yeo. Both Andrew and I are registered liquidators. We are also registered trustees in bankruptcy. Andrew has worked in the insolvency industry—and is therefore a practitioner—for approximately 13 years. I have had over 20 years of experience in the insolvency industry. I have also worked in personal insolvency and with the Bankruptcy Act since 1982.

I will tell you a little bit about Pitcher Partners so that you understand where we are coming from. Pitcher Partners is an accounting practice which provides accounting and business related services to the middle market. In Melbourne it is the fifth largest accounting and business advising practice. It specialises in providing advice to the middle market, particularly to family owned type businesses. Together with our affiliated firms in Sydney, Brisbane and Perth, we represent perhaps one of the larger accounting and business advisory practices in Melbourne servicing that particular market.

I need to say at the outset that we probably need to be a little bit upfront about potential conflict of interest that both Andrew and I have today. On the one hand, because we are both registered trustees in bankruptcy, if this legislation were enacted without any change, it would represent a significant increase in work for people such as Andrew and me—insolvency practitioners, people that deal with personal insolvency. In short, we would probably make a little bit more money than we are doing at the moment out of the process. At the same time both Andrew and I are partners in an accounting practice. We, with the 26 other partners that we have, share the risk for each other's actions and therefore we are jointly and severally liable for losses—touch wood—of the partnership at any point in time.

CHAIR—Haven't you had legislation in Victoria to get rid of joint and several liability?

Mr Rambaldi—No, we have not.

Mr SECKER—That was in Western Australia.

Mr Rambaldi—We are in Victoria.

CHAIR—That was part of the negotiations that went through for questions of restricting liability.

Mr Rambaldi—We have joint and several liabilities as members of a partnership.

CHAIR—Okay.

Mr Rambaldi—Most importantly, Pitcher Partners are the pre-eminent accounting firm which caters for small businesses. These amendments strike directly at the thousands of small businesses who are clients of ours; in our opinion they would significantly affect and deter the risk taking and entrepreneurialism of a lot of our clients—obviously, people in small business. We have put a bit of work into the written submission and we have spent a large amount of our own time, resources and money in making that submission, as well as in making others aware of the effect of the proposed amendments.

Why are Pitcher Partners against the proposed changes? Quite simply, we believe that the introduction of these proposed changes will create financial and emotional insecurity to hundreds of thousands of Australians and will act as a significant disincentive to a huge number of Australian businesses, to directors of businesses which are both charitable and non-charitable, and professionals. We support the government's desire to stamp out the practice of high-income individuals abusing current bankruptcy law and deliberately avoiding tax liabilities. The proposals, however, we believe go way beyond what is necessary to achieve this and will cause, in our opinion, unintended consequences and insecurity, pain and uncertainty in the business community.

In our capacity as registered trustees we have seen the best and worst in people in financial difficulty. In our personal insolvency practice in Melbourne we have over 80 personal insolvencies where we are registered trustees—they are active personal insolvencies—which makes us a significant player, if you like, in the personal insolvency area. We have seen a lot of bankrupts in our time. In any year, there are in excess of 20,000 bankruptcies in Australia. It is our view, from our personal experience—and it is also supported, I believe, by evidence produced by the Attorney-General's department—that the vast majority of people that go bankrupt do so not with an intention to abuse bankruptcy laws but clearly because of socioeconomic conditions, perhaps lack of business acumen and sometimes for reasons well beyond their control.

We have seen, however, that there are a small minority of bankrupts that do deliberately set out to abuse their creditors and to abuse the Bankruptcy Act. Andrew will give you a few examples of the sorts of people that we have had in front of us and the sorts of people that we are talking about, and I think Andrew will also talk to you a little bit about the two solutions that we are proposing that should be considered by the committee in going forward.

Mr Yeo—As Gess said, we have certainly seen the two extremes: people who do set out to defraud the system et cetera, and individuals you look at and say, 'Really, in all honesty, I couldn't have done anything differently and if that was me I probably would have ended up in the same circumstances.' I will give the committee some examples of situations that we have come across in our years of practice.

We had a job recently where the client was a brass-manufacturing plant, a very large enterprise that employed a large number of people. A large amount of tooling was required, leased equipment and the like. The business had been operating for many years and, literally, in the space of about 12 months, with a flood of Chinese imports—of lesser quality but their cost was in the order of 50 per cent or less—that company was forced out of business, in circumstances where the directors were trading the business. They were obviously buying new equipment, signing up leases; they personally guarantee those leases in those circumstances. No matter how good a corporate citizen or how proper a director you are, you can still find yourself in financial difficulty and bear the consequences of bankruptcy through no malice, ill intent or even, in that case, perhaps bad management on your part. That is just one example.

CHAIR—You could say that it was the result of government policy in lowering tariffs—and I happen to be in favour of lowering tariffs.

Mr Yeo—I use that example purely as illustration. There are many thousands of situations. Another client we advised sometime ago was a farmer. He employed a farmhand in his business. On a particular day they were craning a silo off the back of a truck with a small portable crane. Unfortunately, as the farmhand was manipulating the silo the crane touched the overhead power lines and the farmhand was badly injured. In that situation the insurance company—there were some disputes and I will not go into the whole detail—considered that there were real liabilities arising from the farmer's point of view because of that action. The gentleman did not die but there were injuries. Again, it was another circumstance where you think that you have insurance and maybe it is not there.

There are some far-fetched examples. Gess acted as trustee in bankruptcy a number of years ago for a hairdresser. The hairdresser specialised in hair extensions. For one particular client the glue that joins the hair and the extension failed and the hair started to fall out. The client ended up suing the hairdresser for having a nervous breakdown. The insurer denied liability for the hairdressing salon and the hairdresser did not have the financial resources to fight the litigation and ended up bankrupt. I raise that one because it is such a far-fetched example and I suppose the point that I am trying to get across is that you can never cover all your possible bases in these circumstances.

Another situation regarding a profession was where we acted as trustee in bankruptcy a number of years ago for a solicitor. She was in partnership with her husband, who was also solicitor. While she was distracted with her son who are suffering from cancer and having chemotherapy, her husband—perhaps under the stress or for whatever reason—defrauded the trust account and exited town with the cash. Because of the nature of the joint trust account she was left to carry the can. Again, I suppose it is the same example in that you are responsible for your partner's actions even if it is not the individual concerned.

I will just finish off with one example which really centres on the legislation. It is a hypothetical example—and in a moment I will get to how in terms of the provisions we think it is best to catch the bad guys without squashing everyone else. 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. I think that is the greatest mischief in terms of the amendments. They are just some examples.

In terms of solutions we set out in our paper, we would favour the introduction of what we have termed a 'special act of bankruptcy'. Under the present legislation, as trustees in bankruptcy under section 120 we can attack transactions such as transfers of property and the like that have been entered into by a bankrupt within two or five years of the commencement of the bankruptcy. The commencement of a bankruptcy is a technical date relating to the earliest act of bankruptcy within six months. We propose a special act of bankruptcy being defined as widely as is necessary to specifically include situations where individuals did not file, and therefore pay, tax assessments. We propose that, instead of the six-month rule, those would have an indefinite clawback would have the rules apply from a different date. In other words, if I have not lodged my tax returns and paid the tax payable on those for 10 years, then the two- and five-year clawback rules which presently apply would actually kick in from that date.

CHAIR—Much like the proposal you said that for every year you fail to pay—

Mr Yeo—Exactly.

Mr Rambaldi—Perhaps the earliest date that you have not lodged your tax returns would be the date that you would go back to. If that tax return is outstanding and there is a liability that has not been paid—

CHAIR—So you are in agreement with the chartered accountants' proposal.

Mr Yeo—I have not seen the ICA proposal; I have not had a chance to read it. The same provision can also apply for section 121—that there be a deeming of the transfer if the transfer took place at a time when tax returns had not been lodged and assessments paid.

Mr Rambaldi—I think it is fair to say that we see that the current provisions substantially do address these issues but we do see problems with the current provisions. Section 121 is the indefinite clawback period. Section 120, as Andrew says, is the two- and five-year rule of clawing back property. Those sections rely on the ability of a trustee in bankruptcy to show that there was either insolvency or likely insolvency at the time the property was transferred. Many of the problems associated with recovering property and the inability to recover property are caused by the difficulties that trustees have from time to time in showing that there was insolvency. Incorporating a special act of bankruptcy would eliminate that sort of argument, certainly in circumstances where people avoid liabilities and use bankruptcy to avoid their tax liabilities.

CHAIR—So are you saying that the special act of bankruptcy is the failure to lodge a return?

Mr Rambaldi—The failure to lodge a return.

CHAIR—If that is an act of bankruptcy, it applies to everything.

Mr Rambaldi—We would say that where there has been a failure to lodge a tax return, subsequently the person becomes bankrupt and there is a tax outstanding which relates back to that tax return then the date of that failure is in fact the act of bankruptcy and the bankruptcy is deemed to have commenced from that date and not the actual date the person was made bankrupt. That is consistent with relation back principles that we currently have with bankruptcy law and practice.

CHAIR—It is, with regard to two to five years, but you are saying that a tax office debt is of a different character and nature to any other debt and that if you default on payment of that debt you are committing an act of bankruptcy. But all other creditors would then be brought in.

Mr Yeo—I might just clarify that the proposal is not to be able to use that act of bankruptcy to bankrupt someone. It really is a technical mechanism in terms of how far a trustee can claw back in the event someone eventually does become bankrupt. If someone does go bankrupt and it is found that they have not lodged their tax returns for seven years or whatever it may be then the clawback revisions relate back from that earlier date because there will essentially be a deeming of the—

CHAIR—Yes, but it will relate back for all creditors.

Mr Yeo—That is right.

CHAIR—But it is only a defaulting with regard to that particular type of debt—that is, a tax debt—that the trigger would operate.

Mr Yeo—That is right.

CHAIR—It would not be anybody else's debt.

Mr Yeo—You could define that special act as narrowly or as widely as is necessary.

CHAIR—If you defined it widely it would be even worse than this.

Mr Rambaldi—The issue we have is we are really trying to have a rifle gun approach to it. Insofar as there are deficiencies, we see that it relates to high-income earners who fail to pay their taxes.

CHAIR—Yes, but this is a problem: that seems to have been the intent. That seems to have been what people set out to do. As I said, in reality this has turned out to be a bit like long-line fishing. It is catching everything.

Dr WASHER—What I have in front of me is this: you do not feel there is any need to change the legislation as such in any great way. It is really just a timing factor that is being addressed here. At the moment, this bill proposes indefinite timing; it literally goes on to infinity. Are you saying that, if the ATO generated this bill—which it seems to the Attorney-General's Department has been the major problem—then we should address the ATO specifically to say that if this is their problem then we will allow them to go back to the time when these people did not put in

tax returns—in other words, when they defaulted against the tax office by not putting in returns—and retrospectively take it back to that time?

Mr Rambaldi—Yes.

Dr WASHER—That sounds reasonable to me. It might have knock-on implications, but we have a lot of knock-on implications in this current bill. Are you saying the legislation we currently have is adequate to bring people to task if it is applied properly?

Mr Rambaldi—Yes. For example, it is on the public record that a barrister by the name of Cummins had not lodged tax returns for many years—

CHAIR—We discussed that at great length this morning.

Mr Rambaldi—Then you would be aware that section 121 was used effectively to recover—

CHAIR—The tax office says it is on appeal, so it does not want to lock in too much.

Mr Rambaldi—The point we are making is that there is a piece of legislation that can be used. To assist in the use of that legislation, we are proposing a special act of bankruptcy which would assist greatly in being able to recover property from people who have set out to abuse the system.

CHAIR—I would be interested to know—I have asked this question several times and have not really had a proper answer—how often trustees use section 121. How often do you use section 121?

Mr Yeo—Very rarely.

Mr Rambaldi—Not often. That is due to a number of factors. In bankruptcies, perhaps more so than in corporate insolvencies—we are also liquidators—sometimes the major assets are houses or items of wealth. For those who want to hide assets, to do so they transfer them across. Therefore when a trustee pursues that action, they come to it on the basis of there being no assets in an administration to fund legal action to recover the assets. That is the first problem. Secondly, as I say, with section 121, the greatest difficulty is showing when a person was actually insolvent.

CHAIR—You also made a comment in your submission that you thought it would not be a good idea to give the Family Court original jurisdiction.

Mr Yeo—I think we gave a word of caution on that point. We certainly support the amendments, by and large, as they relate to family law, particularly the removal of the binding financial agreement exemption for transfers under the Bankruptcy Act. There was a word of caution about the role of Family Court judges and their understanding of the concept of creditors, and that also applies to the Federal Court's understanding of the family law side of things. It is our experience that they have been trained in and deal with very different areas, and they are very different concepts. There is some danger that Family Court judges will need to be trained and to come up to speed with the concept of creditors and bankruptcy and the role that

that takes. But we certainly support the removal of the binding financial agreement exemption under the Bankruptcy Act. That was gaining some momentum.

CHAIR—We are talking about the Jodee Rich case?

Mr Yeo—Correct. We did not get a test case out of that in the end because the parties backed down.

CHAIR—You gave them one back?

Mr Yeo—Basically, yes. I think most trustees in bankruptcy were waiting for the test case to arrive, and the proposed legislation has overtaken that. We would certainly support it, because I think it was potentially an avenue for people to rort the system. I am not by any means saying that everyone who enters into a binding financial agreement does so to defraud creditors, but there is an avenue there, so as trustees we would certainly support the closing of that potential avenue. Whether there was a gap in the door, who knows; we did not get the test case.

CHAIR—Isn't the question of whether or not they are legitimate separations the real problem with those cases?

Mr Yeo—That is right. The problem under the binding financial agreement was that there was no necessity to have that legitimate separation, which lent itself to the possibility of using it as an abuse.

CHAIR—One of the matters that was raised here this morning was really quite an interesting one, and I would like to hear what you have to say about it. Supposing there has been a financial settlement and a particularly bitter divorce, and one party feels that they have had to pay too much over and says, 'I'm going to get you,' and that is all they are interested in—and we know there are plenty of those around. The person who is ordered to hand over assets says, 'Right, I'm going to go bankrupt and they can attack your settlement and fix you up, good and proper.'

Mr Yeo—Do you mean before the court stamps the order?

CHAIR—After that.

Mr Yeo—I am certainly not a family law expert, but my understanding is that the only way you can do that is to attack it under the Family Law Act, if you can show that the agreement—I have forgotten the exact words—is a sham.

Mr Rambaldi—In fact, there is a presumption the other way in bankruptcy—that is, if there is a family court order, you are protected or the property which is subject to a family court order is protected.

CHAIR—That is the position now.

Mr Rambaldi—Yes.

CHAIR—What will be the position if this becomes law?

Mr Yeo—It is only removing from schedule 4 or 5—I have forgotten which one—the binding financial agreement. If you still go off and get your agreement stamped by the court—I think they are section 79 orders and, again, I am not a family law expert, so do not quote me on the exact terminology—that would still have the protection under the Bankruptcy Act. As you have just pointed out, sometimes there can be a race between creditors and a spouse.

CHAIR—There could be time to do that, I suppose. Has anybody any further questions?

Mr MURPHY—I will just make a comment in conclusion. I am interested in your special act of bankruptcy, but at the end you suggested other avenues. You said:

> Professions should be encouraged to seek to strike off individuals who intentionally set about to ignore their taxation obligations, and use bankruptcy as a shield.

In case you missed it, notwithstanding the bankruptcies out there in the public domain, the taxation commissioner has made it quite plain that he is prohibited from providing that information to professional bodies. The advice of other eminent experts in this field is that he is not prohibited because of his public knowledge. It is a nonsense and we should be doing something about that. We would agree with you on that.

Mr Yeo—I would have to say the same thing. Our understanding, quite clearly, is that it is public information; it is on the public record. I am not sure if you have heard from CPA Australia yet, but I know they have a process of striking out members who do become bankrupt. You would have to talk to them as to exactly how they get the information when they just do a search from time to time of the bankruptcy records, but it is certainly on the public record. That section may prohibit the tax office deliberately knocking on the door of an organisation, but it is certainly out there. Most other organisations do find a way of getting the information and having the members dealt with if necessary and if appropriate.

Mr Rambaldi—The Law Institute of Victoria is the same. As a solicitor becomes bankrupt, the Law Institute will prevent that solicitor from practising as a solicitor in public practice. The person may be able to be employed as a solicitor but not practise in public practice.

CHAIR—I think you will find that they cannot even practise as a solicitor; they can only practise as a law clerk. That is certainly the case in New South Wales.

Mr Rambaldi—I am not sure about that.

Mr Yeo—I am pretty sure in Victoria they can still practise as a solicitor.

Mr Rambaldi—As an employee.

Mr Yeo—Yes.

CHAIR—You can have a restricted practising certificate, can you?

Mr Rambaldi—Yes.

Mr Yeo—The way that it is designed is that it is basically anything which ensures that you do not manage a trust account.

Mr Rambaldi—Yes.

Mr Yeo—I should also add that, although it does not always help, the regulations for most bodies—certainly for CPA Australia—require the individual once they go bankrupt to advise their professional body. Whether that happens is another question. It is a starting point.

Mr MURPHY—Certain members of the legal profession did not do that.

Mr Yeo—Yes, I certainly acknowledge that that would be the case. Not everyone will be following those rules.

CHAIR—It is the Bar Association. That is the difference—I keep telling you that, John. You have to understand there is a difference.

Mr MURPHY—They are a law unto themselves.

CHAIR—There are two other questions. You also raised the question of constitutionality and whether this is a seizure of property without just terms being payable. The other argument is that it is a proper exercise of the bankruptcy power under section 51 and of the incidental power. Have you done a good comparison of that or have you just put it in the submission as a possibility?

Mr Yeo—We have just put it in. As much as we are not family lawyers, we are certainly not constitutional lawyers either. It is really our own view.

Mr Rambaldi—A number of barristers have said that they have concerns about constitutional issues, so we felt it was appropriate to put that in and alert you to that potential problem.

CHAIR—We are certainly alerted to it. The other thing I want to ask is about the balance of risk. I have made the statement on a number of occasions that I think the legislation seems to be an attempt to quarantine creditors from risk whereas when you are doing business you must assume greater or lesser risk and the market adjusts the value of that risk according to the return that you may or may not get. You have something to say about that balance between debtor and creditor rights and the risk. Would you like to say something about that?

Mr Rambaldi—We start from the premise that, from our point of view, the current bankruptcy law and other law has been there for a number of generations. It really does set out the rules, if you like, by which people can understand how they can enter into business, what risk they take and how best they can protect themselves, using the law to do so in a prudent and legal way. We think that these proposed changes would really affect those rules so that for people going into a position of risk the risk is phenomenally greater because not only would they stand to lose whatever assets they have at the time they go into that business venture but they stand to lose assets which the family has accumulated over many years. That is the point we want to make. The risk profile is significantly changed through this.

CHAIR—It does seem that the risk is being assumed by the family of the bankrupt, doesn't it—particularly the spouse of the bankrupt?

Mr Yeo—That is absolutely right. A barrister I know made the point that he is waiting for the amendments as they stand to come through because he will come down for breakfast in the morning and his wife will serve him with an injunction order to stop him going to work and risking her assets. He makes the point flippantly but it has that actual effect. By one party in the family going off to work they are essentially risking and prejudicing the assets of the whole family.

CHAIR—This legislation has absolutely no provision for a contribution other than a monetary contribution. The court may consider non-monetary contributions but nowhere else is that considered consideration in a transfer.

Mr Yeo—Correct—and nor do we have any formula or anything like that. We have a list of eight factors that the court should take into account with no weightings or grades. As we have said in our submission—and I think other submissions have said it—there is great uncertainty. Once you have paid one mortgage payment on a house property it is tainted property, subject to the other provisions, and it is into the mix—the blender. As to how much disappears will be up to the court's discretion.

CHAIR—And whether the court is having a good day or a bad day.

Mr Yeo—Correct.

Mr Rambaldi—We said before that we have come to the committee with some conflicts. On the one hand, if the legislation goes through, it will generate a lot more work for us. On the other hand, as professionals in public practice, if this legislation goes through, the risk is such that it would be difficult for us. Some real decisions would have to be made about the way in which we would conduct a business regarding the risks we would decide to take. It will also be difficult to bring people up through the profession. To bring people into a profession at the moment, they have to come up and be shown that, yes, there is risk but there are benefits. When an imbalance starts to occur, it is going to be difficult to bring people up into professions.

Mr SECKER—Or to go into small business.

Mr Rambaldi—Or to go into small business. We see that with our clients.

Dr WASHER—This proposal was generated from or has spilled out of the ATO and the Attorney-General's office. But does the current system let down the general run-of-the-mill creditors that you look after out there?

Mr Rambaldi—In some respects, that is a hard question to answer. I think, by and large, the system is adequate. There are rules in place and they are workable. With adequate funding, moneys can be recovered. We have many examples of bankruptcies where, with funding, you see the legislation having its full impact and returns coming back to creditors. The rules are there and you can tweak them a little. Certainly with regard to section 121, the rules can be tweaked a

little. That would certainly help, particularly if we focus on where the problem is or where we perceive it to be. But, by and large, the system works and is effective.

CHAIR—What would you do to section 121?

Mr Rambaldi—Incorporate a special act of bankruptcy.

CHAIR—I see; that is where you would put it.

Mr Rambaldi—Yes; and a presumption of insolvency. We also speak about a presumption of insolvency. Where certain events occurred, such as the non-lodgment of tax returns, there could also be a presumption of insolvency.

CHAIR—So that overcomes the difficulty of proving a person's insolvency at the time of the alienation of property.

Mr Rambaldi—It does. It is not a concept which is new; it is being used overseas and also in corporate insolvency. You have a presumption of corporate insolvency, for example, if adequate books and records are not maintained. That is particularly relevant here, if we are talking about trying to claw back transactions that occurred many years ago, because under current laws—tax laws and other laws—there is a requirement for books and records to be maintained for a certain period.

CHAIR—That is right, and we are going back beyond that period.

Mr Rambaldi—We are going beyond that, so it would be important to have that.

CHAIR—That is an interesting concept. Thank you very much for coming today. I have found your evidence to be most useful.

Mr Rambaldi—It is our pleasure.

CHAIR—We presume that, if we need to come back to any of today's witnesses, we will do so. Thank you very much; your evidence has been very helpful.

Proceedings suspended from 3.43 p.m. to 3.57 p.m.

HOUGH, Mr Warwick Paul, Director, Workplace Policy Department, Australian Medical Association

CHAIR—Welcome. We have received a submission from you and we have authorised it for publication, but I wonder if you would like to make an opening statement.

Mr Hough—Firstly we would like to thank the committee for the opportunity to appear before it today. The AMA has taken a very keen interest in this issue. We would like to highlight the fact that we do support the major aim of the bill, which, from our reading, is that it does seek to chase those high-flyers who are deliberately rorting the bankruptcy laws in order to fund an extravagant lifestyle that they would not otherwise be able to have. However, from both a professional point of view and a small business point of view, we feel that the proposed legislation goes well beyond that particular role. The AMA or the medical profession has faced, for example, significant problems with insurance. We do acknowledge that a lot of good work has been done by the government in that area, but the association has also adopted very much a wait and see attitude about the long-term viability of those changes.

CHAIR—Which particular changes?

Mr Hough—This is the medical indemnity—

CHAIR—The medical indemnity legislation that you have?

Mr Hough—That is correct. It has addressed many of the insurance concerns of the profession. From the small business point of view, we do not think that it strikes the right balance. We think that many small business people operating under unincorporated structures, sole traders and partnerships use bankruptcy laws in quite a fair fashion at the moment to protect themselves from risk—to protect their personal assets and those of their families. We believe that the bill opens up a lot of those legitimate arrangements to scrutiny. The current rules are quite clear as to what small businesses can and cannot do, which does aid them in their financial and business planning. Obviously, whilst we have had the benefit of the reforms in the medical indemnity area, other professions still have some issues with insurance, and people in those areas may well suffer as a result of the bill. I suppose the AMA has struggled to understand or come to grips with the basis of the far-reaching nature of the bill, particularly given the joint task force report which focused largely on the high-flyers rather than the small business community, which this bill certainly pulls under its wings.

We would also highlight that there have been some opinions expressed that this is a great aid to those creditors who are in small business and who are not paid for their services or products by other small businesses that go bankrupt. In that regard, we would highlight that this would provide them with very little protection. If they are dealing with a major buyer of their goods or their services and that buyer goes bankrupt, small businesses really do not want to be wrapped up in the courts for years chasing those assets. It is sometimes the case, as we saw in the retail sector with Harris Scarfe, that their assets can be constituted by an organisation with which they have a great many dealings. When Harris Scarfe went bankrupt, because of the extent to which a

number of suppliers were dealing with that particular company, unless they had the protection of bankruptcy laws they themselves would have lost all of their assets as well.

So rather than wrap people up in the courts, it is important to recognise that small businesses ought to have some rules to allow them some protection if their debtors go bankrupt. It is also important to recognise that businesses have a range of tools out there already to protect them from bad debts. For many people who do end up in the bankruptcy system and their businesses are owed money, it is often the case that the business has not particularly diligently chased up those debts in those circumstances. They were the broad comments I wanted to make at the start.

CHAIR—According to the list that we were given by the Australian Taxation Office, doctors do not seem to have been availing themselves of these bankruptcy provisions to avoid tax. Are you aware of that? Does that surprise you?

Mr Hough—Our understanding is that in general doctors have not used the bankruptcy provisions to avoid legitimate taxation payments. Because they carry the risk of medical indemnity, doctors have sought to structure their personal affairs to make sure that their personal assets and those of their families are not at risk. If you look at some of the figures that the Royal Australian College of General Practitioners has put out in regard to the business structures for the medical profession—GPs in particular—at least 34 per cent of those doctors operate in an unincorporated fashion. We believe the figure is actually higher than that, because about 28 per cent of GPs operate in what we call associateships, which can be a combination of different business structures—sole traders, partnerships or incorporated companies. From the point of view of avoiding the risk of medical indemnity claims, well before there was ever any contemplation of such risk, doctors have structured themselves to make sure that the assets of their families are protected. But they certainly have not, from our knowledge, used the provisions to avoid paying tax.

CHAIR—According to these stats, from 2002 to 2004—and this is a document that shows the number of professional people who have gone bankrupt, the debt that they owed, how much the ATO debt was and the total assets available—of the professions, no medical practitioners showed up in 2002 as bankrupt. In 2003, one went bankrupt owing half a million dollars. There was no debt to the ATO and $300,000 worth of assets was available. In 2004 no medical practitioners have gone bankrupt. The concern that you obviously have with the introduction of this legislation is that if they were successfully sued in a negligence action and they did not have any assets to adequately pay if the insurance cover failed, their assets could be traced back to their families, their spouse or whomever they had made the arrangement with.

Mr Hough—That is the particular concern that we have. Certainly, the figures that you have provided demonstrate that doctors have been observing all of those obligations. The particular concern—certainly throughout the medical indemnity situation—was that there was a great deal of evidence of doctors who had in the past considered, or were considering, transferring assets into partners' names or structures in order to make sure that those assets were protected. We do acknowledge, obviously, that the reform measures that the government has put through have helped that situation considerably. The profession's fear is a longer term one in the sense that the current reforms do rely heavily on government subsidy. They also rely on tort reform within the states, and for doctors, whilst we hope the reforms are effective in the long term, there is still an environment of fear and concern about what will happen in the future, particularly given the way

the courts can move around with damages orders and so on. It does depend on the political will of the government in power at the time to keep up those heavy levels of subsidy.

Mr MURPHY—In your submission where you list the alternative, you conclude:

> ... the Act could be amended to provide that existing time limits prescribed under the Act for the recovery of transferred assets would operate from the time the person became bankrupt, or the date of individual's last tax return—whichever is earlier.

What do you propose if someone files their tax return for 2003-04 and becomes bankrupt tomorrow but has successfully put their assets out of reach of their creditors before now? This is what this draft bill is trying to achieve.

Mr Hough—The alternative put forward by the AMA was one suggestion. We are trying to say that this particular problem appears to have arisen largely because of a certain group in the community who were using the bankruptcy laws to avoid the payment of taxation debts and other debts and that what appeared to be quite a strong indicator of wrongdoing was the non-lodgment of a tax return. That is the basis on which we put that particular suggestion forward. In terms of other alternatives, I am not quite sure whether the AMA is well qualified to comment on the degree of complexity of all the various options available, because at the end of the day that is not our area of expertise. We have tried to focus on the broader policy perspective rather than some of the detail and we would certainly be supportive of any alternative that focuses these laws back on the actions of those people who are deliberately seeking to do the wrong thing in the fashion that was identified by the joint task force report. We would certainly be supportive of any alternative that met that requirement.

Dr WASHER—Mr Hough, I would like to ask you specifically about the more targeted approach you spoke about in your submission. Can you flesh that out? I find the idea—and yes, there is tainted property with insurance and other concerns in certain professions as well beyond our ability to handle—of taking a family's home et cetera, which could happen under this new act, pretty repugnant. Can you flesh out your suggestions on this?

Mr Hough—It is important to note that we are not commenting simply from the point of view of a professional insurance issue. The AMA has a strong small business membership, with general practice and specialist private practice, so we do recognise that insurance is one issue. There is also the issue of your building burning down and not being properly insured and people going bust for those types of reasons. In terms of this particular problem that has been identified, particularly by the ATO, our view is that this bill, whilst on its face it has very noble intentions, captures the entire small business community and professional community in an all-encompassing attempt to deal with the issue, and with very little evidence to support that action other than what is in the joint task force report.

The reason we have suggested a more targeted approach is that we do not really think it is appropriate to catch so many groups in society, particularly small business. It lessens the ability of small businesses to take risks and balance their ability to compete with larger businesses, which is very important. Having the ability to transfer your assets does allow you to compete more effectively with much larger organisations. We really think that the bill should simply focus—whether it be through taxation laws, the Bankruptcy Act or other special legislation—

simply on those people who have done the wrong thing, in the fashion that was identified in the joint task force report.

Mr MURPHY—I do not think we could necessarily be confident from the answers we got from the tax office this morning that a targeted approach would be successful, because it was clear that the tax office could not see the wood for the trees in relation to barristers. Leaving the medical profession to one side, we are trying desperately to get the balance right between targeting those high-flying professionals who behave dishonestly as opposed to the genuine sole trader or small business operator who, through misfortune, bad management or incompetence, goes bankrupt.

Mr Hough—I have dealt with the ATO in a number of capacities, representing small business for the last 12 years. The ATO probably has more tools than any other creditor, and more powers available under legislation than any other creditor, to chase particular debts. Businesses have an enormous number of tools available to them at the moment to manage their own debtor situation properly, such as following up debts, not letting things get beyond 45 days—all of those types of things. You invariably find with those small businesses who do grow and who have problems with bankrupt debtors that in many instances they have not used the basic tools that are already available for them. I think it is important that there be a more targeted approach combined with some better education of small business owners about how they can use what is available already, whether it be credit reporting services; having proper credit application forms in place; using credit cards, which is increasingly happening; and taking deposits for goods and services.

There are all those types of things that are available to them and they are widely used by people who do have good credit control practices. There should be a focus on education in those areas. The ATO certainly has the ability to monitor certain industries and professions as far as their performance is concerned. Those types of tools are readily available to them and they have a great deal of power under existing legislation in terms of reclaiming debt. If you ask most small business owners they will tell you that the balance is already quite heavily in the favour of the ATO. It is important that in the pursuit of addressing a problem that has been identified by the joint task force report this legislation does not discourage small business people in general from taking on risk—this legislation takes it very much into a dangerous piece of territory.

CHAIR—What is your suggestion to meet the policy objective, which is to prevent high-worth professionals avoiding tax? What do you suggest as the solution?

Mr Hough—We have put one suggestion forward, which was using non-lodgment of a tax return as an indicator of dishonest behaviour. The ATO obviously has the ability to more closely monitor particular professions and use those tools more effectively. It may well be possible to tighten the existing laws more readily. Alternatively, there could be some sort of approach whereby certain exclusions were acknowledged or certain other criteria—which we have certainly not identified as yet—needed to be satisfied before action could be taken. We at the moment have simply gone along the lines of looking at the non-lodgment of taxation returns and have not given a great deal of thought to any other alternatives.

CHAIR—What are you saying about taxation returns?

Mr Hough—We have said in relation to the proposed amendments that according to the joint task force report, as we read it, anyway, the non-lodgment of a tax return is a pretty good indicator that there is some dishonest activity afoot on the part of the debtor. We have suggested that, using that in conjunction with the existing bankruptcy provisions, the time limit within which the court could go back in terms of recovering assets would actually start either in accordance with what the existing provisions are or, if a person has not lodged a tax return, you could actually go back to the date that they last lodged a tax return and then commence the existing time periods from that particular date. That would—

CHAIR—So you are in agreement with the chartered accountants?

Mr Hough—Yes.

CHAIR—Do you think this whole new raft of legislation is necessary or do you think the existing legislation should merely be amended?

Mr Hough—We think the existing legislation merely requires some amendment. We highlight the fact that the existing provisions of the bankruptcy laws—it is very important to put this forward—provide a great deal of certainty for small business in how they can structure their personal and business affairs. That allows their financial advisers to give them appropriate advice. Opening up the system to much broader discretion on the part of the court defeats much of that type of approach. From that perspective, it is good law from a small business perspective—it provides them with certainty yet it also provides creditors with adequate protection.

CHAIR—You consider that doctors are small business people?

Mr Hough—Yes, in the main.

CHAIR—In regard to the negotiations you had to limit liability for personal indemnity purposes, was not getting rid of joint and several liability part of that deal?

Mr Hough—I cannot comment on that. The main area we have looked at is the enhancements that have taken place to the premium support scheme—the changes put through to assist doctors with their premiums once they get to a certain level, and putting caps on claims where the government comes in and assists the medical insurance organisations with paying out those claims which have kept costs—

CHAIR—But you have doctors who work in partnerships, don't you?

Mr Hough—Yes, that is correct.

CHAIR—I might be imagining it, but I thought it was part of the deal. If it is joint and several liability, they can pick the rich partner and leave the others alone.

Mr Hough—I cannot comment, unfortunately; as Director of Workplace Policy I do not cover that.

CHAIR—We will check that out through our own research. Thank you very much for coming and giving us evidence today.

[4.20 p.m.]

GILBERT, Mr Ian Bruce, Director, Australian Bankers Association

CHAIR—Welcome. This morning, Mr Gilbert, we did receive your submission and authorised it for publication, but I wonder if you would like to make some opening comments.

Mr Gilbert—We welcome the opportunity that the committee has presented for us to provide some assistance to the committee in its deliberations on the draft bill—and we are very pleased to see that it did reach this committee. I apologise for the late delivery of the submission and I trust that that has not caused the committee members any unnecessary inconvenience. Continuing a theme that I believe the committee has heard today about the policy development of this particular measure, it is important to identify what was the failure that brought about the joint task force report and the ensuing draft legislation. With respect, it was not about the fact that people necessarily took advantage of bankruptcy laws to avoid payment of tax but in fact that they were permitted to do so. It does concern us in terms of strict policy development that the failure is not being addressed in this legislation; it is picking up the consequences.

I am actually a member of the Attorney-General's Bankruptcy Reform Consultative Forum which has been looking at this proposal for some 15 months or more. There is—and we have heard evidence of it today—a level of concern from a majority of people on that forum that the bill is missing the mark. If one wants to speak of where the balance lies, it would be our submission that the balance lies in ensuring that the tax office is in a position to take advantage of the many powers that it has at its disposal. I read of the case of a barrister who had failed to lodge a tax return for 17 years and accumulated an enormous tax debt to the Commissioner of Taxation. However, I ask the committee to consider this: had the barrister not paid his other creditors, would he have survived for 17 years?

CHAIR—No.

Mr Gilbert—I suggest not.

CHAIR—Exactly.

Mr Gilbert—So, without labouring the point, I think the issue really is: what is the failure that has occurred? There are some aspects of the draft bill which I dare say we will get into with your questions concerning the uncertainty and possible impact in relation to third parties of the bankrupt and, particularly for my members, lending arrangements.

CHAIR—One of the questions that I asked earlier bore in mind the reach that the legislation would allow a trustee in bankruptcy to have. How would that affect possible bank lending policies?

Mr Gilbert—It has been a difficult thing to assess from the bill. The concerns that banks have are in relation to their dealings with the entities who are not bankrupt—

CHAIR—They are the ones I am talking about.

Mr Gilbert—They are the entities who become the recipients of tainted property. As we know, a recipient does not need to have any knowledge of the tainted purpose before the property becomes tainted and the tainting can be recycled through replacement property. The banks have two concerns. One is this: if banks take a mortgage over tainted property, does that security stand up against the claim of a trustee that it is tainted property? We are concerned that section 58(5) of the Bankruptcy Act may not extend the vesting of property upon bankruptcy to the vesting of property by court order, which is a different concept. If that were the case and section 58(5) did not apply, then a bank security could be avoided through this legislation. That would be a very serious outcome for lenders.

CHAIR—In other words, you are saying it would not automatically vest; it would depend on the decision of the court.

Mr Gilbert—Correct. Even when the court ordered that it vested, it does not necessarily mean that it is vested within the meaning of section 58, where the protection for the security arises. We believe this would be an unintended consequence. In all of the discussions that we have had in the consultative forum, it has not been the intention of the government to displace a lender's priority, so we would put that issue in the class of an unintended consequence.

CHAIR—Let me get this straight. You are saying that if this new regime were in place a court ordered vesting may not be caught by the provision that says:

(5) Nothing in this section—

which is the vesting of property upon bankruptcy under the general rule—

affects the right of a secured creditor to realise or otherwise deal with his or her security.

Mr Gilbert—That is right. It is a technical point but it is certainly an important point. The second area of concern is in lending generally, where a bank is lending to a small business. It might be a partnership, it might be a sole trader, like a doctor, or it might be a company into which assets have been transferred from an individual, on advice from their accountant, for taxation purposes and other planning purposes. 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 and antecedent transfers of every business that comes along to make an application for finance?

CHAIR—One of the people giving evidence today, and I think it was a person from Professions Australia, made the point that it could be contrary to the effect of Torrens title. The question that you are posing there is almost like having to do a search going back to a good root of title under the old system.

Mr Gilbert—Yes, exactly. In fact, I think that is a point that we have not explored, but it is a very valid one: that is, being a federal statute, it could undermine the whole principle underpinning Torrens title.

CHAIR—That covers the field. Yes.

Mr Gilbert—I suppose the concern is that, if one moves to policy development that is not actually targeting the failure, these are the sorts of ripple effects and unintended consequences that can flow from legislation that has as broad a reach as this bill would have, if it ever became law.

CHAIR—The question we were looking at is this: suppose tainted property is transferred to a spouse, by whatever means, and the spouse disposes of that tainted property—sells it to an arms-length third party—can you continue to trace that property into the hands of the bona fide third party or does it stop at the money that comes to the person who has traded that tainted property? Do you have the money traced wherever it goes—or both?

Mr Gilbert—I think it is clear from the bill that the money that a person receives becomes tainted property and if that money is then converted into another asset then that asset becomes tainted property. It is not clear to me whether once tainted it is always tainted in terms of subsequent acquirers of that asset. It would be tainted if the original transferor then became bankrupt, possibly, and had not paid tax or had transferred it for a tainted purpose. But I do not glean from the draft bill that it necessarily requires a tracing purpose beyond the immediate transferee.

CHAIR—Let's not take it to a third party. Say a spouse who has acquired tainted property then transfers it to a child for some consideration, does that property still remain tainted and traceable?

Mr Gilbert—It could do. Again there are a lot of uncertainties with this draft bill. It is difficult to say where the court would draw the line.

CHAIR—The question is does tainting actually affect the ownership? I made this analogy before: does it put tainted property in a similar category to stolen property? What is the nature of the title you are transferring?

Mr Gilbert—It is subject to a potential claim by a trustee that it was not acquired in circumstances where you can assert a better right to the property than the trustee.

CHAIR—Which of course is to take it back to the old root of title.

Mr Gilbert—Exactly. Those facts in themselves create sufficient uncertainty—certainly in a lender's mind—to make someone take, I would have thought, extra precautions and possibly introduce less flexibility in their lending arrangements.

CHAIR—Supposing you are a conveyancer and you are dealing with the transfer of a property which is like the one in the example I gave, where the tainted property has gone to a spouse from someone who has subsequently become bankrupt and the spouse has then alienated the property to a child: if you know the spouse, who could be divorced by now, owns this property and you are dealing with this person as the vendor to the purchaser and you know the property is less than full value for the consideration, is it then your obligation in all instances to

go back and check as to the nature of the intent of the alienation by the bankrupt? Does that become your obligation?

Mr Gilbert—If, under the bill, the tainting does flow through in the way you have described, unless indefeasibility of title upon registration is paramount, there would be additional obligations for a prudent conveyancer to follow.

CHAIR—What we have established is that title is not indefeasible, isn't it?

Mr Gilbert—I am not as confident that tainting necessarily flows through to subsequent dispositions by the original acquirer, but if it did it would create those sorts of problems.

Mr MURPHY—Mr Gilbert, how do you think we could get the balance right in light of your concerns about this legislation? We have been hearing a constant theme. People are saying that we are using a sledgehammer to crack a nut but there are corrupt people who employ bankruptcy and family law to avoid paying tax—and principally when they go belly up they only have one creditor of note and that is the Taxation Commissioner. How do we weave a passage through all that to ensure that we get the dishonest people and not the poor unfortunates who fall between the cracks?

Mr Gilbert—I will go back to simple principles and say that if the tax laws were enforced then the chances of losses to the Tax Office would be severely minimised.

Mr MURPHY—Are you saying that the tax laws are not enforced?

Mr Gilbert—I can only read what appeared in the joint task force report. It seemed clear that there had been a fair degree of inaction in relation to some celebrated individuals. I would like to raise, for the committee's consideration, a problem that could arise, which would give rise to the exact opposite of what the policy intent is—that is, if one passes this law what encouragement is there for the Tax Office to be vigilant?

CHAIR—Yes, we did address that earlier. It could stay in the too-hard basket for a lot longer.

Mr Gilbert—Yes. Up until about a decade ago the Tax Office had priority under corporate law for unremitted group tax. That was taken away and the Tax Office is quite active in recouping unremitted group tax.

CHAIR—I am very aware of it; I took evidence about it.

Mr MURPHY—Or—dare I say it, Madam Chair?—there could be a new modernisation agreement.

CHAIR—I think the last modernisation agreement that I was involved in was most unfortunate for the then commissioner.

Mr Gilbert—I hope that answers your question, Mr Murphy.

Mr MURPHY—I think there has been a constant theme that the Tax Office has not been proactive enough, reactive enough, does not have enough resources and should do more. That is outside the purview of this committee.

Mr Gilbert—I would like to put on the record that I am not being critical of the Taxation Office. I am simply making the observation that this failure, and the way this situation arose, has occurred not because people use bankruptcy to avoid payment of tax but simply because they were permitted to.

Mr MURPHY—It would appear that the Taxation Office is under-resourced, but that is not for us.

CHAIR—We do not know that that is the case. All we know is that nothing was done.

Dr WASHER—Do you mean financially or in other ways, John?

CHAIR—We do not know.

Mr MURPHY—Probably, both.

Mr Gilbert—I would also like to say—and we mentioned this in our submission—that we are not advocating that people should avoid their tax obligations.

Mr MURPHY—No-one is, Mr Gilbert.

CHAIR—Nobody is saying that; we are all concerned that we prevent this happening.

Mr MURPHY—We are not here on a witch-hunt of the tax department; we would like to get answers so we understand how the situation with the barristers was allowed to occur, because we suspect—and I can certainly demonstrate this in some of the questions that I have asked of the relevant ministers—that it extends beyond members of the legal profession. That is obvious. So we want to do something about it but everyone is telling us that this draft bill is far too harsh. We do not want to water it down, as I said earlier today, and be back where we started.

Mr Gilbert—I suppose there is the serious downside to that where the failure is not being targeted, it is picking up the ripple effect—the consequence rather than the actual cause. That is where our concern in a policy sense lies. Can I also say for the record that the Insolvency and Trustee Service people should be commended for the work they have done within the Attorney-General's bankruptcy forum. It has been a difficult issue. The joint task force report was really a tax office inquiry. There were no private sector people on that task force.

CHAIR—Are you saying that the task force was tax office driven?

Mr Gilbert—It was government agency driven. There were no private sector representatives on the task force.

Mr MURPHY—There was the tax office, the Attorney-General's—

CHAIR—Yes, I know who was on it, but who was the driver of it and who actually provided the drafting instructions? Do we know that?

Mr Gilbert—I do not know. I would like to put on the record the terrific work that Mr Gallagher, who heads up ITSA, has done, we think, on a very difficult course through the forum on this issue, because it was debated quite extensively within the consultative forum.

CHAIR—How would you sum up the feeling of the forum?

Mr Gilbert—The forum is a mixture of representatives of lawyers, the finance industry, insolvency practitioners, and includes a financial counselling representative. I think all the evidence I have heard today reflects a lot of the concerns that those people on the forum have had about the policy development on this bill.

CHAIR—Did the forum consider the task force report or did you get to see the legislation and then you were asked to comment?

Mr Gilbert—No, we saw the task force report. There was an edited version of it—there had to be because apparently there was some information in there that was really not appropriate to be in the public domain. We saw a very adequate copy of the report and some policy proposals that were developed from that.

CHAIR—What did the forum think should happen? Did the forum endorse this course of action?

Mr Gilbert—No. The forum does not vote; the forum is a consultative forum that simply provides a set of views for policymakers to think about.

CHAIR—What I am trying to get at is whether the forum is supportive of this course of action, which is this legislation?

Mr Gilbert—My view is that the majority of the members on the forum were not supportive of tackling that problem in the way that is being proposed.

CHAIR—But they were supportive of tackling the problem?

Mr Gilbert—Everyone agrees that people who are avoiding payment of tax should be chased down.

CHAIR—But they do not believe that this particular solution is the way that they would like to go?

Mr Gilbert—Yes, that is right.

CHAIR—Okay. Is there any reason that you could see that, if this system went into operation, it could result in an increase in, say, interest rates because there was a greater risk involved in lending?

Mr Gilbert—I could never say that from the position where I sit. All I can say is that pricing and lending decisions are based on credit risk, and whether pricing would change as a result would obviously be a matter for each bank, or financier for that matter, to determine. I would not want to say to this committee that that is a likely outcome. I think that would be a gross overstatement of a concern. But that is not to say it could not happen.

CHAIR—Is there a differential that the banks use with regard to a Torrens title or old system title?

Mr Gilbert—I am not aware. Security, if it is good, is fine.

CHAIR—If it is a good root of title, it is not a problem?

Mr Gilbert—Yes. These days general law title is gradually being converted over. Certainly in Victoria there was a major project to have it converted over—

CHAIR—There are still profits around.

Mr Gilbert—so those long hours in dusty offices, going through piles of documents, have been avoided.

Mr SECKER—It seems that every time I go to see my bank manager for a new overdraft or something, there is an extra piece of paper to read and sign as a result of laws we have brought in or someone else has brought in. If this act were to come in—you may have addressed this issue earlier before I came in—do you think that there would be more things that you would have to provide for a company or a partnership or single entity every time you had to do an overdraft? Does it make your job as, say, bank manager—or the job of the people whom you represent—more onerous?

Mr Gilbert—It could make a little bit of extra red tape in terms of, for example, inquiring as to the source of the assets of the company that is seeking the borrowing. If it was a relatively new venture and it had been a transfer from a partnership into a company structure—for all the legitimate reasons that people use company structures for taxation and so forth—there is that possibility. I could not predict what a bank might or might not do, but there is always the possibility that those questions might need to be asked.

CHAIR—There is of course the possibility that by creating a company and transferring the assets into the company that of itself can taint the assets.

Mr Gilbert—Exactly. By going from a partnership to an incorporated entity, you might want to raise capital, and a company is a far better way to raise additional partnership capital—

CHAIR—But you are up against that main test or main point?

Mr Gilbert—Exactly. The difficulty of course is that the 'tainted purpose' is presumed, unless proven to the contrary by an allegation by the trustee.

CHAIR—That is right.

Mr Gilbert—There is not even a requirement in the legislation for that allegation to be based on reasonable grounds. So it is an extremely high-risk situation as it flows through to the third party line of people affected.

Mr SECKER—Can you see any benefits out of the legislation for creditors or the tax office?

Mr Gilbert—We have seen that, whatever advantages there might be for them, they are seriously outweighed. One only needs to look at the number of small businesses that are operating in Australia—there are about one million of them or more—

CHAIR—There are 1.6 million.

Mr Gilbert—It has grown significantly since I last looked. The bankruptcy statistics are pretty stable, and, in fact, falling slightly. The last time I looked, there were just under 2,000 bankruptcies nationally—I think I am correct in saying that. But when you look at proportionality against business, you will see that there is quite a disproportionate issue here. If it is an innocent third party, a non-bankrupt business, that loses its assets, what happens to all its creditors? There is a ripple effect, a flow-on effect, and I think those issues should be of concern to the policy makers.

CHAIR—Thank you very much for your evidence this afternoon. It will be most helpful in our deliberations.

Resolved (on motion by **Dr Washer**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 4.49 p.m.