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

TUESDAY, 6 JULY 2004

CANBERRA

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **http://www.aph.gov.au/hansard**

To search the parliamentary database, go to:
http://parlinfoweb.aph.gov.au

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS

Tuesday, 6 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 9.10 a.m.

CHAIR—I declare open this second day of public hearings 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. Yesterday the committee took evidence from the Australian Taxation Office and from witnesses representing peak bodies such as the Certified Practising Accountants, the Institute of Chartered Accountants, the Insolvency Practitioners Association, Professions Australia, the AMA, the Bankers Association and Pitcher Partners.

It was evident to the committee that there was support amongst the witnesses for the stated government policy that high-income professionals should not be able to avoid paying income tax by going bankrupt, having previously transferred their assets ostensibly beyond the reach of the trustee in bankruptcy. However, all witnesses except the Australian Taxation Office opposed the bill in its current form. Concerns were raised about some of the potential consequences of implementing the proposed bill, which goes much further than the stated intention. In particular, witnesses raised the potential for the exposure draft of the bill to have unintended outcomes, particularly the impact on small business and possible uncertainty of title arising from property being deemed to be tainted. Some witnesses were concerned about the implications of retrospectivity and the reversal of the onus of proof. The constitutionality of the bill was also questioned. Indeed, some witnesses expressed the view that existing legislation was adequate to address the problem of the high-income earners segment of the community using bankruptcy as a means to avoid tax obligations. Others suggested ways in which the current legislation could be strengthened.

Today the committee will continue to hear evidence on the draft bill from other representative bodies, such as the Australian Financial Counselling and Credit Reform Association, the Council of Small Business Organisations, the Australian Institute of Company Directors, the Masters Builders Association and the Law Council of Australia, and from practising solicitors Cleary Hoare Solicitors. Firstly, we will hear from the Insolvency and Trustee Service Australia, ITSA, and the Attorney-General's Department, which have been involved in the formulation of the proposed legislation.

[9.13 a.m.]

ALDERSON, Mr Karl John Richard, Acting Assistant Secretary, Office of Legal Services Coordination, Attorney-General's Department

DUGGAN, Mr Kym, Assistant Secretary, Attorney-General's Department

BERGMAN, Mr David, Adviser, Policy and Legislation, Insolvency and Trustee Service Australia

GALLAGHER, Mr Terry, Chief Executive and Inspector-General in Bankruptcy, Insolvency and Trustee Service Australia

CHAIR—Welcome. The committee has invited you here today because the Insolvency and Trustee Service Australia and the Attorney-General's Department are the agencies responsible for the exposure draft bill. Thank you for coming this morning. Mr Gallagher, would you like to make an opening statement? The others can then contribute as they wish.

Mr Gallagher—Thank you, Madam Chair. As you know, the most significant measure to be introduced by the bill will be the courts' power to make orders for the recovery by the bankruptcy trustee of tainted property owned by a person or entity other than the bankrupt. Although this measure arises from the joint task force report and the ATO's experience with a small number of bankrupt barristers which exposed a significant problem with the Bankruptcy Act, the policy problem is not just about the ATO's problems or tax avoidance. The barristers' case demonstrated just how easy it is to shield property from a bankruptcy trustee by placing it in a friendly entity while enjoying the benefits of that property. The loophole exposed by the barristers is available to a significant number of people and has undermined the credibility of the bankruptcy system for ordinary people.

The draft legislation involves weighing up the competing interests of some people to put their interests beyond the reach of their creditors and creditors to be paid what is owed to them by people who have the financial capacity to pay. It is important to remember that the legislation sets up two stages to be followed by the bankruptcy trustee who wishes to recover property held by someone other than the bankrupt. The first stage is to identify tainted property. The second stage is for the court to consider whether all or part of that property should be available to pay the bankrupt's creditors.

In general terms, property will be tainted if the bankrupt provided the funds or property used by the entity to acquire the property, the bankrupt's purpose in providing the funds or property was to ensure that the funds or property would not be available to pay creditors, and the bankrupt used or derived a benefit from the property now held by the entity. It is important to remember that if there is tainted property the court has the discretion in terms of whether and how much of that property should be recoverable by the bankruptcy trustee for the benefit of creditors. This is the second stage I referred to just before. It is not the case that property becomes available to the trustee simply because it is within the definition of tainted property. This aspect of the

amendments seems to have been misrepresented in much of what has been written about the exposure draft since it was released for public comment.

In every case, the court will have to decide whether the property is recoverable by the trustee, having regard to such matters as: the extent to which the property's current market value reflects the contributions, both financial and non-financial, made by the bankrupt and any other person or entity; the nature of any interest that other entity has in the property; and the extent to which the bankrupt has used or derived a benefit from the property. They were the comments I wanted to make about the particular tainted property provisions. Would you permit me to make some brief comments about the other provisions of the legislation?

CHAIR—Yes, indeed. I might add at this stage that when we heard from the tax office yesterday we did not take evidence from them on the aspects of the Family Law Act. We are going to have them back to deal with that, but I guess you are going to say something about that today?

Mr Gallagher—Indeed.

CHAIR—That would be useful for us to hear about too.

Mr Gallagher—I will get onto those last, and I will ask my colleague Kym Duggan to mention those. A second component of the legislation relates to the income contribution scheme. Currently the income contribution scheme requires bankrupts earning over a statutory threshold of income to contribute towards their bankruptcy a proportion of that income. This income contribution is generally garnished from wages paid to employed bankrupts or from accounts held by them with a financial institution. The amendments will address difficulties in enforcing income contributions against bankrupts who are not employed or do not have an account with a financial institution.

The proposed amendments are designed to give bankruptcy trustees access to a bankrupt's income before it reaches the bankrupt. Under the amendments, a trustee will be able to require a bankrupt to pay all of their income into a bank account that is supervised by the trustee. The trustee would then be able to use existing powers to garnishee income from the nominated bank account. Trustees will be able to come to an arrangement with the bankrupt for regular withdrawals from the account to meet the bankrupt's living expenses while ensuring that the balance of the account remains sufficient to meet the contribution liability and consent to additional withdrawals to meet unexpected liabilities or where a balance has accumulated in the account that exceeds the amount required to meet the bankrupt's contribution liability. Decisions made by the trustee will be reviewable by the Inspector-General in Bankruptcy in the first instance and then by the Administrative Appeals Tribunal.

A third component of the legislation relates to property transferred under family law financial agreements. The Bankruptcy Act allows a bankruptcy trustee to recover certain property transferred to another person in the period leading up to bankruptcy. However, these provisions do not apply to property transferred pursuant to a maintenance agreement or maintenance order. The definition of a maintenance agreement currently includes a financial agreement entered into under part VIIIA of the Family Law Act.

The bill proposes two amendments that are designed to ensure that a bankrupt cannot use family law financial agreements to defeat the claims of creditors. The first will exclude financial agreements from the definition of a maintenance agreement. This will allow the trustee to recover property transferred at less than market value or as a preferred transfer to a creditor where that transfer occurred pursuant to the terms of the financial agreement. The second amendment will introduce a new act of bankruptcy that will occur when a person is rendered insolvent as a result of assets being transferred under a financial agreement. As a result, the person's bankruptcy will be taken to have commenced at the time of the transfer and this will allow the trustee to recover property transferred under the financial agreement. The last thing I want to refer to in my introductory comments is the interaction between family law and bankruptcy.

CHAIR—I want to interrupt you for a moment. With the financial agreement that you have just described do you mean that all the assets in the financial agreement become liable for the trustee in bankruptcy, so in a legitimate divorce there would be nothing left in the financial agreement for the spouse and children?

Mr Gallagher—It just means that the definition of a maintenance agreement now does not include a financial agreement so it avoids the capacity of a bankrupt to enter into—

CHAIR—I understand. The bankrupt can say they are going to assign the property in lieu of fortnightly payments or whatever, and the effect of that agreement would cause the would-be bankrupt to become bankrupt because he has made himself insolvent. Are you saying that every asset that is transferred by that agreement then becomes subject to the trustee in bankruptcy and he is then in competition with the Family Court? It has to be registered before it is effective, anyway.

Mr Gallagher—The property is available to the trustee under the current provisions of the Bankruptcy Act. In other words, if it was transferred at less than market value it can be recovered under the clawback provisions.

CHAIR—But you know that there is a situation where under such an agreement, on a divorce settlement, there could be a transfer of an asset in lieu of maintenance payments. Is that attacked too?

Mr Gallagher—I understand that that does occur under financial agreements, yes.

CHAIR—So that means that all the money that would be paid by way of maintenance instead goes to the creditors, so the kids miss out and the creditors get the dough.

Mr Gallagher—I do not think that would necessarily follow.

CHAIR—I did not ask if it was necessary; I asked if it is possible for that to occur.

Mr Gallagher—Not if the court took into account the contributions of the parties to the division of property.

CHAIR—But, in the first instance, it would. So the spouse, who would be losing the asset in lieu of maintenance, would then have to find the money to appear before another court to try and prove there was a contribution, and that they were entitled to it, thereby racking up legal costs on the divorce.

Mr Gallagher—In making the application, the trustee would take into account whether the transfer was to defeat creditors and whether it was undervalued. If the financial agreement took into account a trade-off between maintenance and other property then the trustee would not be inclined to make application.

CHAIR—But you do not know that. He may; that is the point.

Mr Gallagher—He may, but the court would take—

CHAIR—That is all I want to establish: that the whole thing may be attacked and the family could miss out, but the creditors could get the money.

Mr Gallagher—This amendment would enable the transfer to be attacked, but the decision would be based on an outcome of whether the transfer was undervalued and all of the contributions—

CHAIR—So there would be another court action to establish that?

Mr Gallagher—Yes. If there was an application made, it would be a court procedure.

CHAIR—You would have the family law proceedings here, then you would have another set of proceedings over here, so it is getting fairly expensive at this stage?

Mr Duggan—In relation to financial agreements, there would not be any proceedings on foot necessarily. The financial agreement could in fact deal entirely with the property settlement.

CHAIR—It might be a very bitter and twisted divorce.

Mr Duggan—Yes, indeed, but generally it would not be a financial agreement in the circumstances that you describe.

CHAIR—We do not know that. It could be.

Mr Duggan—It would be unlikely.

CHAIR—We do not make legislation for things that are unlikely. We like the law to be certain, don't we?

Mr Duggan—Of course, but anything that is dealt with by a financial agreement is not dealt with by an order of the court.

CHAIR—It has to be registered, though.

Mr Duggan—No, not under our legislation. A binding financial agreement—

CHAIR—No, not under your legislation; under the family law legislation.

Mr Duggan—No, under the Family Law Act, a binding financial agreement no longer needs to be registered with the court. Under amendments made by the government in 2000 there is no longer a need for binding financial agreements to be registered by the court. This is the purpose of these amendments. Under the binding financial agreement provisions of the Family Law Act, there is no longer an opportunity for a court to supervise the provisions of binding financial agreements.

CHAIR—Maybe it would be better to put the provisions back into the Family Law Act.

Mr Duggan—That is a matter for government, but these amendments in part relate to—

CHAIR—So the withdrawing of the amendment to the act in 2000, taking away that requirement, in fact had some unintended consequences of its own?

Mr Duggan—The government took the view at the time that we should do that as much as possible to allow parties to resolve their family law property matters—

CHAIR—Between themselves?

Mr Duggan—Between themselves, without involving a court.

CHAIR—So this was an unintended consequence of that?

Mr Duggan—It is a way of describing it, perhaps, yes.

Mr SECKER—What protection does either party have under those non-registered arrangements?

Mr Duggan—Do you mean parties to the marriage?

Mr SECKER—Yes.

Mr Duggan—Under the binding financial agreement provisions of the Family Law Act, once a properly entered into binding financial agreement is made between the parties then a court no longer has jurisdiction over the property that is covered by that binding financial agreement and it is binding as between the parties.

Mr SECKER—So if both parties agree to it then it is binding?

Mr Duggan—Absolutely.

Mr SECKER—What about the situation where a spouse—for example, a husband—feels pretty hard done by in a divorce case—and there are plenty of them around, as you would

know—and he thinks, 'I can use these new amendments to the Bankruptcy Act. I've got nothing to lose here; she has taken just about everything I've got. I'll make myself go bankrupt and those assets that she got can be challenged or taken over by the trustee.'

Mr Gallagher—It would not be the bankrupt who took that action; it would be the trustee's property then.

Mr SECKER—That is right. The end result is the same. If the bankrupt purposely made himself bankrupt, then the trustee could get at the assets of the wife, or ex-wife, who he is disgruntled with.

Mr Gallagher—Yes, but the trustee would only make application if he or she believed that it would have a reasonable prospect of success in recovering property, and that would depend on whether the terms of the financial agreement represented a fair distribution.

Mr SECKER—I am sure that a disgruntled husband could go out there and say, 'I gave that to her dirt cheap and it is worth more than that. I know you've got valuations and things, but I did this on purpose to avoid creditors coming to me.' He could quite easily go out there and say that, so then it becomes tainted property because he is saying he did it on purpose to avoid creditors.

CHAIR—And then she has to prove that that was not the case.

Mr SECKER—Then you have got another court case.

Mr Gallagher—The trustee's application would still depend on the merits of the case, and if it was to defeat creditors then presumably there is an action, but that would have to take into account—

Mr SECKER—So you are not denying that it is possible?

Mr Gallagher—I am not denying that the application is possible, but I am saying that the trustee would not be inclined to make an application if it did not have a prospect of success.

CHAIR—I think you are missing the point that Patrick is making. Where malice is involved, where a party comes along and says, 'I did this to avoid creditors—that is the only reason I assigned this property,' the trustee in bankruptcy would have to take that at face value. He would have to accept at least that it was probably true or possibly true. What are the other creditors going to say? Here is the creditor saying he has done this to defeat creditors, that is the only purpose he did it; you have got to go for that property.

Mr Gallagher—The trustee has a statutory obligation to act in the interests of creditors and debtors and also has a statutory obligation to administer the estate in a commercially sound way.

CHAIR—Correct.

Mr Gallagher—First of all, he or she would need to be funded by creditors to take this action. Creditors will be advised by the trustee of the prospects of the recovery.

CHAIR—And there you go: you have got a prize witness who says, 'This is why I did it.' That fits with the legislation. The creditors fund that action. She, the wife, who got the property, has not got anyone to fund her to defend it; and she has to meet the reverse onus of proof and prove it was not tainted. Is that fair?

Mr Gallagher—Yes, it is certainly the case—

CHAIR—That is fair?

Mr Gallagher—that if the litigation is commenced then there are costs involved. But I would still say that the trustee is in the position of making the decision and is not beholden only to the arguments of the bankrupt but has to take into account the prospects of clawing the transfer back.

CHAIR—What happens if—taking Patrick's example a bit further—the trustee has had a bit of a rough time in the family law court himself, he is a bit sympathetic to the case and he goes for it? What I am putting to you is the balance can be very much against the spouse, who is normally going to be the wife in this day and age, and the children. If you have someone being malicious—and we know it goes on: people take out AVOs, all sorts things—saying, 'I did it to defeat creditors,' and creditors put up the dough and they go for the property, then she has to go and find money she has not got to try and prove that it was not tainted property. Is that fair?

Mr Gallagher—It is a possible scenario. If the trustee makes the application then you do have litigation; that is correct. It will be decided on the merits of the case.

CHAIR—You did not answer my question: is it fair?

Mr Gallagher—I am not sure whether I can comment about whether a decision of a trustee is fair or not. I just say that a trustee is obliged to act in a commercially sound way in the interests of creditors and debtors.

CHAIR—Yes, but you can act in a commercially sound way that totally defeats the purpose of the Family Law Act. In other words, what we are talking about here—I think this is what Patrick was getting at—is competition in public policy: the competition of public policy for family law and public policy for creditors. So we have got families versus creditors in terms of public policy. It is a bit difficult, isn't it?

Mr Gallagher—Indeed. It has been a significant issue for a long time It is recognised that there is an inherent conflict, if you like, in situations where family law and bankruptcy interact. It is one of the factors behind the amendments that are proposed in the legislation.

CHAIR—Supposing we put the agreements back as they were previously, subject to the jurisdiction of the family law court.

Mr Gallagher—I am sorry, the financial agreements?

CHAIR—Supposing we went back to the situation prior to 2000, or even a slightly different situation, where agreements had to be sighted and agreed to by the court: is that one way around the problem?

Mr Duggan—It puts a heavy onus on the court, in a situation where you are requiring registration—which, generally speaking, is an administrative type process—for the court to take account of the interests of all creditors, for example, before it does register the provisions of the agreement.

CHAIR—So you are saying the family law judges are not up to that task?

Mr Duggan—I am saying that there would be a significant onus on the court. I am not in any way saying that the judges are not up to that task; they are indeed. I am simply indicating to you that there would be—

CHAIR—Mr Duggan, I think I would say there was always a heavy onus on the courts because they are determining people's lives.

Mr Duggan—That is certainly true.

CHAIR—If you are making the point subtly that you do not think family law court judges are up to that sort of commercial work, say so.

Mr Duggan—Of course I am not making that point.

CHAIR—Okay.

Mr Duggan—What I am indicating to you is that there was a fundamental approach by government that it would make, to the extent possible, an avenue available to parties to settle their differences without having to involve a court. The government takes the view in the family law policy context that, generally once litigation is involved, parties tend to become polarised and settlements are much more difficult to engender. That is the view of the government.

CHAIR—There was a recommendation of the standing committee that looked at reform of the Family Law Act that a tribunal be established for custody and property settlements—and I think it included property settlements.

Mr Duggan—No, it was predominantly for custody matters—that is, for what we call residence matters these days.

CHAIR—Did it not include property?

Mr Duggan—There is a constitutional difficulty in relation to the tribunal dealing with property matters. I could go into that. Fundamentally, the issues were designed around children.

CHAIR—Do you mean arbitration versus judiciary?

Mr Duggan—That is right. I might point out too that these amendments also flow to some extent from the amendments that were made in 2003 to deal with the so-called Jodee Rich case, which you may recall.

CHAIR—Yes, I recall it extremely well. The fact of the matter is that he reneged, so we did not get a test case, did we?

Mr Duggan—No, indeed. Arguably, the reason for that reneging was the swift action taken by government in relation to that matter.

CHAIR—Can you expand on that a little?

Mr Duggan—Sure. There were a range of amendments passed in 2003 which effectively allowed a third party to challenge an agreement in circumstances where it was done to defeat their best interests, if you like. I can provide more details to the committee if it interests you.

CHAIR—That was for the purpose of getting an injunction? It would then proceed under section 121?

Mr Duggan—Effectively, yes, that is right. The binding financial agreement would effectively fall to the ground and then you would be dealt with. I must hasten to add that Mr Rich was not at that time bankrupt and was not subject to the bankruptcy legislation. That is litigation yet to be finalised. The concern was that, by using the binding financial agreement provisions at the time, he was removing considerable assets from the reach of potential creditors, if you like. That is why the government made those amendments, which as I say do not relate to bankruptcy, because there were no bankruptcy proceedings at the time.

CHAIR—But they would have subsequently?

Mr Duggan—I cannot predict what may have happened in that regard. As I say, Mr Rich is engaged—as I understand it—in protracted litigation in relation to some of those matters, so I cannot predict what might have happened. The effect of the binding financial agreement arguably was to remove from the reach of potential creditors a significant amount of his assets.

CHAIR—Putting in the third party intervention would allow someone to get an injunction to prevent that occurring. In the meantime, they would argue that it was likely that creditors would need to have access.

Mr Duggan—That is right.

CHAIR—They would have to argue that point and presumably they would get an ex parte injunction to begin. Then they would have to go back and establish the likelihood of creditors needing access to those assets for that injunction to remain in place, wouldn't they?

Mr Duggan—Effectively, what they would have needed to establish was that the agreement was entered into for the purpose, effectively, of avoiding the potential creditors being paid.

CHAIR—That is right. But whereas you could get that fairly easily, I suppose, ex parte you would have to go back if it was going to remain in force and you did not become bankrupt for some considerable period of time. You would have to argue a very solid case for that injunction to remain in place, don't you think?

Mr Duggan—Yes, I think that is probably right.

CHAIR—All of that did not happen, because he did not go through with the agreement.

Mr Duggan—That is right. You are quite right—there was no test case because the Riches, as I understand it, rescinded the agreement between them.

CHAIR—We have had suggested to us new acts of bankruptcy, which seem quite interesting. They would commence, say, 10 years ago, when someone had failed to put in their return—they would date from that period. Then you could go back two and five years before that, which would give you good reach. Other people have talked about strengthening section 121 and, indeed, the suggestion I just made to you would strengthen 121 to the extent that it would then avoid the need to prove insolvency at the time under a section 121 case, because you would already have a deemed special act of bankruptcy. There seemed to be quite a lot of good thinking coming from the witnesses yesterday. I do not know whether you followed proceedings but there seemed to be some quite good ideas that perhaps can achieve the same thing you want to achieve—that is, that creditors are not defrauded by using mechanisms of bankruptcy—but without some of the really unattractive side-effects that seemed to be coming out of the hearings. Please continue with your comments.

Mr Gallagher—The last area of amendment that I was going to refer to was the interaction between family law and bankruptcy. I would invite Mr Duggan to briefly outline those proposals.

Mr Duggan—There are effectively two purposes in the changes to the Family Law Act provisions as part of this package. The first, which we have discussed to some extent, are what might be called the anti-avoidance measures. The second, which I will discuss now, deals effectively with the interrelationship between family law and bankruptcy law. As you are probably aware, this has been a vexed issue probably since 1975. The bill will effectively merge the Family Court's jurisdiction on bankruptcy and family law matters in cases where these areas interact, and the amendments will allow the Family Court to consider the non-financial contributions of a non-bankrupt spouse for the acquisition of family property.

CHAIR—So who will consider that?

Mr Duggan—The Family Court.

CHAIR—Who is actually going to sit?

Mr Duggan—Under the bill as currently drafted, Family Court judges would deal with these matters. I might point out that Family Court judges currently have significant experience in dealing with quite complex property matters which involve significant taxation and other issues. I am aware that there are some concerns expressed by parts of the Law Council, for example, about whether it should be the Family Court or the Federal Court that deals with these matters. All I can say is that the Family Court has significant experience in dealing with quite complex property matters from a whole range of aspects.

CHAIR—In that case, your comment earlier about a heavy onus being put on the judge does not stand, does it?

Mr Duggan—I did not suggest that the onus could not be discharged by their honours; I simply indicated that it would be a heavy onus upon them.

CHAIR—No heavier than the onus you are about to put on them right now.

Mr Duggan—That is a matter of conjecture.

CHAIR—Please go on.

Mr Duggan—In particular, the amendments give the Family Court jurisdiction in bankruptcy if the bankruptcy matter is run concurrently with the family law matter. The amendments allow the trustee in bankruptcy to be a party to section 79 property adjustment or spousal maintenance proceedings under the Family Law Act and allow the Family Court to make an order against the relevant bankruptcy trustee as part of a property adjustment order under section 79. They require the Family Court to take into account the making of a property adjustment order under section 79 and the effect of any proposed order on the ability of a creditor of a party to a marriage to recover his or her debt against that party, and they provide that the vesting of property upon bankruptcy has effect subject to a part VIII order—part VIII deals with property under our legislation.

CHAIR—I am going to ask you to stop there: are you reading from something that we have received from you?

Mr Duggan—No, I can make it available to the committee.

CHAIR—I wonder if you can make it available to us because I think, considering the complexity of what you are saying, I would like to have the written document.

Mr Duggan—That is fine.

CHAIR—Can we get copies of it made?

Mr Duggan—This was not actually prepared for submission, but I am happy to make the first two pages available.

CHAIR—Mr Murphy, would you like to ask a question while we are having that done?

Mr MURPHY—Mr Gallagher, when we last met I made reference to my concern that someone was able to be made bankrupt 12 times and I elicited that information from questions that I put on notice. Following amendments in 2002 to the Bankruptcy Act 1996, my understanding is that the Official Receiver can reject a debtor's petition where it appears the debtor can afford to pay their debts and the Official Receiver forms a view that the debtor's position is an abuse of the bankruptcy system and that there are other changes, including strengthening of the trustee's powers to object to the discharge from bankruptcy of uncooperative bankrupts after the standard three-year bankruptcy period. I think people are very

concerned that someone could quite easily go bankrupt; they are concerned about the ease with which someone could file a debtor's petition and that could be effectively rubber-stamped. I would like to know how the system has been operating since those amendments were made to the Bankruptcy Act in 2002—whether we have seen any decline in the number of people filing debtor's petitions.

Mr Gallagher—It has been a feature of bankruptcy law in Western countries for many decades that a debtor can file a debtor's petition and, providing the debtor's affairs are properly disclosed and a statement of affairs is completed appropriately, then the person is bankrupt. That feature has not been sought to be fundamentally altered by these reforms, but it is the case that the government was concerned about that issue you referred to and introduced that amendment. I am not sure that it is very easy to glean from statistics since then—that is a reasonably recent time; the legislation had effect from May 2003—whether the changes have had an impact on reducing the number of people filing a debtor's petition. I do not imagine people who file a debtor's petition are aware of the reform, so I am not sure whether it has had time to influence them, but certainly we seek to have advice by financial counsellors and others prior to presenting a debtor's petition. If it were for a wrong purpose then you would hope that those advisors might advise them against it.

There has been a fall in bankruptcy filings over the past years. I have not got the figures in front of me but there will be a small reduction in bankruptcy filings in the most recently completed financial year, although that is offset to a certain extent by an increase in debt agreements being proposed to creditors. I think the total insolvency numbers are also just slightly down. I do not think the figures have been absolutely finalised yet. I am pretty sure they will be slightly down in terms of gross numbers from the previous year. Whether you can make the direct connection between those numbers and the reform, I am not really able to say.

Mr MURPHY—Certainly bankruptcies trebled between 1990 and 2000. Obviously it was getting out of hand. Everyone who has appeared before us has commented—

CHAIR—Can I follow up your question?

Mr MURPHY—Yes.

CHAIR—You did not get an answer to the question: how many times has the Official Receiver exercised his new power since it was given to him? You were not asking how many bankrupts were aware of the new legislation. The Official Receiver is aware of it, obviously, intimately. How many times has he used that power since it was given to him? That is what we want to know.

Mr Gallagher—I was not aware that that was the specific question. I do not have the statistic in front of me, but it is in the vicinity of 10 to 20 times since it has been introduced.

CHAIR—So it is an effective new power. Would you go away and get us some details on that?

Mr Gallagher—Absolutely, yes.

CHAIR—If a would-be bankrupt wants to challenge, where does their appeal lie—the Federal Court?

Mr Gallagher—The bankrupt can appeal to the Administrative Appeals Tribunal.

CHAIR—Is that the only appeal—the Federal Court, I suppose?

Mr Gallagher—Yes, or the Federal Magistrates Court.

CHAIR—Would you find out whether there have been any appeals?

Mr Gallagher—I do know the answer to that. There was one appeal filed but it was withdrawn before the application was heard.

CHAIR—We would like to know what their occupation is, the size of the debt, whether there is any tax office component and about the assets available.

Mr Gallagher—Yes, we can find out that information.

Mr MURPHY—Mr Gallagher, everyone who appeared before us yesterday effectively said that, because the onus of proof is on the bankrupt to prove that they did not have a tainted purpose, they have all concluded that that assumes that a bankrupt's transfer is for a tainted purpose unless the bankrupt can produce evidence to the contrary. Are you having any second thoughts about the harshness of that provision? We are trying to get the balance right here.

Mr Gallagher—No, we have not. When you say 'we', we are not having second thoughts. The government has issued the exposure draft and has not indicated any change to that.

Mr MURPHY—Why not use the Proceeds of Crime Act, where one gets six months to produce receipts or evidence in relation to one acquiring certain assets?

Mr Gallagher—I am not sure what you mean when you say 'use the Proceeds of Crime provision'.

Mr MURPHY—That could be used now. People are saying that this legislation is too harsh and innocent people are going to be punished because of the onus of proof and also the retrospectivity provisions—everyone is saying the same thing. And I, more than anyone, who prosecuted this myself with questions on notice, would like to think that, when this legislation gets into the parliament after this committee has made some recommendations, it will be fair. Basically, everyone is telling us it is not fair. I want to be convinced that it is fair. You can have a think about it; I do not want—

Mr Gallagher—I will have to think. My first reaction to a suggestion that some of the provisions that relate to proceeds of crime be translated is that bankruptcy is not regarded as a criminal action and people going bankrupt are not—

CHAIR—Fraud is.

Mr MURPHY—I think it is something to consider.

CHAIR—I think what you are getting at is that the commissioner, for instance, can determine to go under the Crimes Act for cases of fraud, which is a crime, and therefore the Proceeds of Crime could kick in. Is that what you are suggesting?

Mr MURPHY—Yes.

Mr Gallagher—I need to perhaps think about it, but I am struggling to see how we could conceive that the bankruptcy law could be changed so that somehow people filing for bankruptcy would be a criminal act, which would bring it into the context of Proceeds of Crime legislation.

CHAIR—No, that was not the suggestion, I do not think, that Mr Murphy was making.

Mr MURPHY—I think most people would think the behaviour of these people, whether it was John Cummins, Stephen Archer or Clarrie Stevens et cetera, was criminal, because they clearly set out to defraud the Commonwealth and avoid making a contribution to this country. I think a reasonable person would say that was criminal behaviour. They did not want to pay any tax—

Mr Gallagher—But is the point that the criminal act was filing for bankruptcy or failing to pay tax? If it was the latter then it seems to me that is the procedure that needs to be addressed outside of this legislation.

Mr MURPHY—Okay. Do the proposed changes in schedule 1 of the draft bill allow the trustee to recover property from a third party, where that property was initially transferred by the bankrupt prior to bankruptcy to an entity and then transferred by the entity to the third party?

Mr Bergman—Only in circumstances where the series of transfers was effectively part of a scheme that the bankrupt knew was going to result in this property ending up in the third party's name. So the provisions say that, where the bankrupt or the person at the time had transferred or provided those funds or that property to another entity through a number of interposed entities, then it could become tainted property. But, if I transferred property to my wife and at some stage down the track my wife decided to make a gift of that property to another person, then it would not be tainted property in the hands of the ultimate recipient of the gift. It is only where the series of transfers is part of the arrangements that the bankrupt is putting in place to transfer the property.

CHAIR—Take your example—you transfer it to your wife and she transfers it for less than full value to your daughter.

Mr Bergman—The bankruptcy trustee would not be able to recover the property from the daughter.

CHAIR—All of this legislation could be defeated by simply having a subsequent transfer?

Mr Bergman—When I say that the bankruptcy trustee could not recover it from the daughter, if it could be shown that the whole series of transfers was effectively one transfer and that the bankrupt had organised this in such a way that it appeared—

CHAIR—But your whole test is about full value being paid.

Mr Bergman—That only relates to the transfer and the consideration as between the bankrupt and the entity who currently owns the property.

CHAIR—A third transfer—

Mr SECKER—That was the second transfer.

CHAIR—The second transfer. Suppose there was a trust or a proprietary limited company and the second transfer was into that entity.

Mr Bergman—It does not matter in a sense whom the second transfer is to, the bankruptcy trustee would still have to show that it was effectively one transfer and just went through a number of entities. If it were done as part of some sham to try to defeat the provisions by making it look like it was a transfer to one person and then a legitimate transfer to others—

CHAIR—This is crazy. You are saying that with regard to the first transfer deeming provisions apply but with regard to second or subsequent transfers there are no deeming provisions.

Mr Bergman—There would not be a connection necessarily between the ultimate recipient and the bankrupt.

CHAIR—Suppose the bankrupt has got the same intent as always and they have worked out that they can transfer the property to Fred Bloggs, a third party trusted by the bankrupt. Fred Bloggs then transfers it to the bankrupt's wife. So the deeming provisions would apply to Fred Bloggs but not to the wife.

Mr Bergman—The transfer could be attacked if the bankruptcy trustee can show that the whole series of transfers was effectively the same transfer.

Mr SECKER—If it went from a wife to a child, that would be highly unlikely I would have thought. Most people would say that is a legitimate way of transferring assets. The trustee would virtually have no hope of getting to that after that second transfer, would they?

Mr Bergman—That is right.

CHAIR—Or you could do it the other way around.

Mr SECKER—The child to the wife.

CHAIR—You could give it to the child first and the child could transfer it to the wife. Your whole edifice would collapse.

Mr Bergman—It will collapse unless the trustee can show that it is all part of the scam.

CHAIR—The whole purpose of your legislation is to have property deemed to be tainted so that the trustee in bankruptcy can go for it without having to prove a whole lot of things, which you can do now under section 121. I am saying to you that your whole edifice can be knocked over by simply having a second transfer.

Mr Bergman—Potentially. To clarify one point in relation to that: if the person who originally received the property was to sell it then the proceeds of the sale or any replacement property could be recovered by the trustee but only from the entity that received the original transfer.

CHAIR—This is not what you are trying to prevent. You are trying to stop would-be bankrupts devolving property to a third person for the purpose of protecting the assets from being available to creditors. That is what you are setting out to do but, by having a second transfer, your whole scheme falls in a heap.

Mr Gallagher—If that second transfer, for example, were to the daughter or the child of the marriage and that person lived in the house—no benefit would be derived if the bankrupt or the bankrupt spouse, for that matter, did not live in the house—that other component of tainted property would not be proven. The bankrupt would have to derive a benefit from the property.

CHAIR—Yes, but the benefit is an unknown quantity and liable to the courts' development of what that might mean in the future. You know that as well I do. At the moment, it has no meaning until the courts have a few cases and decide what it means. Is that true?

Mr Gallagher—True, yes.

CHAIR—You do not know what a future court might say; none of us does.

Mr Gallagher—But it is nevertheless a feature that—

CHAIR—We do not know what it means. As a legislator, I do not think that uncertain law is good law. Call me old-fashioned.

Mr MURPHY—How often is section 121 of the Bankruptcy Act used as a means of recovering property transferred by the bankrupt prior to bankruptcy?

Mr Gallagher—I am sorry but I do not have figures available to me now in terms of the numbers of that.

Mr MURPHY—Could you get that information?

Mr Gallagher—Yes, I think we could probably obtain that from court records.

Mr MURPHY—If you could get that I would appreciate it.

Mr Gallagher—Yes, we could take that on notice.

Mr MURPHY—Do the proposed changes in schedule 1 of the draft bill allow the trustee to recover property that has been transferred pursuant to a property order under the Family Law Act?

Mr Bergman—No. The transfer would not have occurred with a tainted purpose; it would have occurred for the purpose of transferring property pursuant to an order of the Family Court or an agreement registered with the Family Court.

Mr SECKER—You do not have to be registered—

Mr Bergman—A maintenance order has to be registered. It has to be made by the court effectively.

CHAIR—We are not talking about a maintenance order here.

Mr SECKER—We are talking about assets.

Mr Bergman—An order for a property settlement still has to be made by the court. A binding financial agreement does not have to be registered in the court but a property settlement that is made pursuant to a court order—

CHAIR—That is where property is disputed and the court has to determine how it is split.

Mr SECKER—If they agree.

CHAIR—If they agree, it is a different proposition. Mr Duggan, in line with Mr Murphy's question, why are you proposing to allow the trustee in bankruptcy to be a party to section 79 relating to property adjustments? Forgive me, because I do not know the answer to this, but is the property adjustment under section 79 permissible to a financial agreement voluntarily entered into or is it only concerning orders of the court?

Mr Duggan—The way the binding financial provisions work under the Family Law Act is that any property that is subject to a valid binding financial agreement is no longer subject to the jurisdiction of the court. Effectively, once there is a binding financial agreement, that property is taken out of the jurisdiction of the court. It is only property that is not subject to the binding financial agreement about which the court can make an order.

CHAIR—But what is a property adjustment within the meaning of section 79?

Mr Duggan—Property adjustment—property settlement might have been another word we could have used in relation to that—is where the court makes a determination as between the parties as to who gets what, effectively, after there has been a breakdown.

CHAIR—Supposing you have voluntarily entered into a financial agreement which no longer has to be sanctioned by the court but one of the parties to the voluntary agreement finds that there were hidden assets, they can go back to the court to reopen that agreement, can they not?

Mr Duggan—They would not be going back to the court to reopen the agreement; they would be going back to the court to seek an order from the court in relation to those hidden assets. Where those assets are not effectively dealt with by the agreement, the court would retain jurisdiction—that is right.

CHAIR—And you would allow the trustee in bankruptcy to intervene in such a proceeding?

Mr Duggan—Where there is a bankruptcy involved, yes, that would be right. Effectively, the intention is that the bankruptcy trustee would be in the court to protect the interests of creditors. We have a situation where one party—the bankrupt spouse—has in fact gone bankrupt and there are now interests to be protected, or at least considered by the court.

Mr MURPHY—Finally, Mr Gallagher, is ITSA aware of any other jurisdictions in which legislation similar to this bill has been introduced?

Mr Gallagher—I am not aware of any others with legislation of this kind. It is a question of degree. There was a division 4A provision that this is replacing, which endeavoured to attack transfers of property. Most countries that we would compare ourselves with have clawback provisions and provisions that enable trustees to attack assets that have been transferred. I am not aware of any that go as far as these go in terms of taking away time limits and altering fundamentally the notion to say that the trustees should be able to get at the true wealth of the debtor, to take that premise rather than trying to rely on time periods for transfer, which has been identified as the fundamental factor that is so easy to overcome. The point about these amendments is that there have been a number of changes made over a number of years to try to overcome pitfalls, if you like, because people, where you have time frames and onuses in relation to purpose—so proof in relation to purpose—have been very difficult to prosecute. Those were the loopholes that were identified as to these practices that were revealed in the task force report.

CHAIR—Mr Gallagher, one question that was asked yesterday was: in the case of the barristers, if the creditor had been anybody other than the Australian Taxation Office, do you think those persons would have remained not being made bankrupt for as long as they were able to? In other words, there is the fact that the ATO failed to do anything about them when any other creditor is not going to behave in that way. It was 45 years in one case.

Mr Gallagher—A creditor either pursues the debt or writes it off. I think it is unlikely that a creditor would go for such a long period without pursuing their debt. We have provided information to the committee, following our earlier briefing to the committee, about the amount of the debt owed by persons, being professionals in these professional groups, going bankrupt which indicated that Tax is not by any means the only creditor.

CHAIR—I am aware of that. What the data you have given us does not show is the length of time over which the debt was accumulated. It could have been all in one hit. We do not know that at all from looking at those figures.

Mr Gallagher—That is correct; we do not know.

CHAIR—So in that sense those figures do not help the argument. There is no doubt that the answers that we got from the Australian Taxation Office yesterday were inadequate. We did not get proper answers to our questions at all. The idea that section 16 of the tax act prevents the commissioner from making sure that someone to whom he is paying fees is actually paying tax is just a joke, so we were very unhappy yesterday with the answers that we got. There are two questions I would like to ask you. Firstly, given the answer on the question of jurisdiction, is there no other jurisdiction you know of that has this concept of tainted property for bankruptcy purposes?

Mr Gallagher—No, not in the terms that we have drafted here.

CHAIR—Who was responsible for the drafting instructions for the exposure draft?

Mr Gallagher—Jointly, the Insolvency and Trustee Service Australia and the Attorney-General's Department.

CHAIR—Mr Duggan, did A-G's provide the drafting instructions?

Mr Duggan—Indeed, particularly in relation to the family law amendments.

CHAIR—Did they have an input in the drafting instructions for the tax provisions?

Mr Alderson—I was not personally involved at the time, but my understanding is that, because of the shared policy responsibilities for bankruptcy between ITSA and the department, those aspects would have been settled jointly between ITSA and the department. Where they impact on other portfolios, obviously there would be consultation with those other portfolios.

CHAIR—Did you have an IDC?

Mr Gallagher—During the drafting, no. The task force was an IDC and that was at the earlier stages of developing the recommendations.

CHAIR—What about the consulting mechanisms you went through? I understand you have a reform forum. In fact, the Australian Bankers Association told us yesterday that they were a member of it—

Mr Gallagher—Correct.

CHAIR—but they were still opposed to the bill in its current form. I have been supplied with a good deal of documentation relating to people who are presumably members of that forum who are—each and every one of them—bringing up major problems with the exposure draft as it is. I have to say that I think the government has been exceedingly wise to bring it forward as an exposure draft for discussions and consultation.

Many of the witnesses yesterday felt that there was a need for far greater consultation, particularly the people who were practitioners, who are registered trustees themselves and would have to be making many of the decisions that the act would provide for. They were very keen that there should be a much greater consultation period. They felt—as others felt—that, whereas

everyone thinks that it is good that barristers should not be able to avoid tax and other things that flow from that, the unintended consequences that could flow are just huge. I think that they said that they were not consulted. The professionals associations also said that they were not consulted. Is there any reason that that was the case?

Mr Gallagher—I do not think it is the case that they were not consulted. As you indicated, there is a consultative forum that I chair which contains representatives of the various professional and business groups in the insolvency sector. The Law Council, the IPAA and the Bankers Association are all members of that. The task force report came out in January 2002 and there was an issues paper released later that year. That was followed by discussions in the consultative forum on the recommendations in the issues paper.

CHAIR—Let me give you an example. We have just been talking about section 79. The Wesley Community Legal Service, whom you consulted, say in relation to the recovery of assets:

The proposal is that a trustee of a bankrupt estate would have the power to apply to the Federal or Family Court for a declaration akin to a property order under s. 79 FLA and applying the existing Family Court criteria for adjustment of property contained in s79(4), 75(2) and case law.

The proposal is unattractive for many reasons.

The cost of a property application in the Family Court is considerable. A matter that proceeds to a full hearing can cost the parties in excess of $100,000 in legal fees. For this reason over 95% of Family Law disputes settle. The number of cases in which a trustee will be able to fund such an application will be miniscule.

The applicant trustee will be at a significant disadvantage in such a case. The broad range of non-financial contributions can outweigh the importance of financial contributions in the mind of a Family Court judge. Proving such non-financial contributions is difficult, due to the lack of objective evidence. The Family Court depends upon the evidence of witnesses. In a case where the trustee is calling the bankrupt to give evidence about non-financial contributions, it is unlikely that the bankrupt will have a keen recollection of facts that will assist the trustee against the respondent spouse.

The process of obtaining evidence and proceeding through the courts will be slow and complicated. There will be many opportunities for the respondent spouse to obfuscate and delay.

With trustees charging $300 an hour or more for their time, it is likely that much of the money recovered will simply go to trustee's fees.

If the law applies only to married persons, there will be incentive for wealthy couples not to marry. If it applies to de facto couples, then some will seek to put assets in the names of children, other relations or friends.

The proposal becomes increasingly messy as attempts are made to seek a s.79-type declaration against a de facto spouse, same sex partner—

and I will come to those in a minute—

child, other relative, friend, business partner, trust, family company or any one of these living overseas.

The proposal is not limited to bankrupts who put assets in the names of spouses to avoid tax. It should be limited to financial contributions made in tax years where tax should have been remitted but was not. In other words, the process would be an enhanced form of tax collection, rather than a general power which trustees can use in any situation.

It continues on at great length. I think those few paragraphs outline just how huge the complications could be—and the cost of the proposal would be astronomical. Again, I ask: is that good public policy?

Mr Gallagher—I will make a couple of responses to that—perhaps not by way of challenging the fundamental premise of that letter. However, I think that submission is based on the recommendations of the task force, which are not the provisions that have been drafted here. Recommendation 3 of the task force recommended essentially that, in the event of a bankruptcy, the property interests of the bankrupt and the bankrupt's related entities or the bankrupt's spouse be determined by the Family Court in accordance with family law principles. That recommendation was not proceeded with. One of the reasons for that was constitutional advice that it would have been in breach of constitutional power. It was replaced by the division 4A recommendations or the tainted property provisions. So I think that submission is based on recommendation 3 made by the task force and not the proposals ahead. I do not know that that necessarily addresses your point.

CHAIR—It does. There is a letter here from Mr Burmeister which alludes to some constitutional problem he foresaw. He does not spell it out but says, 'I think you've fixed it now.' Is he referring to that?

Mr Gallagher—He is referring to an agreement that the division 4A proposals that we have before us satisfy the constitutional requirement.

CHAIR—What you are telling me is that the tainting provisions have replaced these suggestions?

Mr Gallagher—Correct.

CHAIR—These comments were made as a result of looking at the original task force report? Have you asked those same people to look at the tainting provisions?

Mr Gallagher—The issues paper led to consultation through our consultative processes, and the proposal was revised as a result of feedback in relation to those complications.

CHAIR—Did the Wesley Community Legal Service have the opportunity to comment on the tainting provisions before those provisions were included in the exposure draft?

Mr Gallagher—I do not think they were explicitly asked about them. They are not an agency on the forum. They are represented by the financial counselling sector, I think.

CHAIR—These documents were requested by the committee. The people and organisations who provided these documents were not part of your forum at all. I will just go through them: National Legal Aid, the Victorian Bar, the Federal Magistrates Service, the Australian Bankers

Association, the Australian Taxation Office, Arnold Bloch Leibler, the Family Court of Australia, and individuals.

Mr Gallagher—They were not part of the forum.

CHAIR—What status did you give their comments?

Mr Bergman—Can we just check the date of those letters. I am just trying to identify when they came in because—

CHAIR—They were supplied to me subsequent to our meeting on 3 June. There is a letter dated 10 December 2002. So this has obviously been in progress a long time.

Mr Bergman—These are comments we received after we published an issues paper.

CHAIR—March 2003.

Mr Bergman—Yes. The issues paper dealt with proposals that were more closely related to what the task force had recommended, and that was the proposal that in every bankruptcy there should be a division of property along family law lines. Following those comments, we revised the proposals and took them to a consultative forum meeting which was expanded to include a whole lot of other agencies, including some community organisations—

CHAIR—So, really, this whole lot—

Mr Bergman—so they were just part of the process.

CHAIR—This whole lot of submissions is not relevant.

Mr Bergman—They are not directly relevant.

CHAIR—They are not relevant to the exposure draft. Some of them are a bit, though.

Mr Bergman—The fundamental issues that were raised at every stage of this process, which are similar to the sorts of things that you heard yesterday, have been raised in relation to every incarnation of the proposals that we have been considering.

CHAIR—But your first go pretty well got slammed by all those people. So you changed your mind and someone went along and thought up the deeming provisions and 'tainted property'. Who thought up 'tainted property'? Whose idea was it? Where did it come from?

Mr Bergman—The concept was developed by us. I do not know that we actually called it tainted property.

CHAIR—So you two gentlemen are responsible for the concept.

Mr Gallagher—As I mentioned before, division 4A of the Bankruptcy Act was introduced in 1987 and, in a sense, was directed at these particular types of transfers. Following the feedback that you referred to, in response to the original recommendations, which as David said was—

CHAIR—No, I know all that. All I am saying is that you two dreamt up the concept of 'tainted property'.

Mr Gallagher—That is to strengthen division 4A, yes.

CHAIR—Terrific: that is a brand-new concept, so we now know where it comes from. But nobody was consulted about whether this was a good or a bad thing, in the way that you did for your earlier proposal.

Mr Gallagher—That is correct. It was not the subject of a new issues paper pointing to that particular proposal.

CHAIR—Okay.

Mr Gallagher—But can I just say that the proposals were discussed at the consultative forum after they were revised into the proposals that they are now.

CHAIR—I have not yet found anyone who has been a member of your forum who thinks it is a good idea.

Mr Gallagher—That is right, but—

CHAIR—Except you and the tax office.

Mr MURPHY—And the A-G's.

CHAIR—I have not heard them express a view as to that yet.

Mr Gallagher—The consultative forum is not a drafting body. It is a consultative forum, and so we were aware of concerns that were expressed—that is correct.

CHAIR—I was just wondering why you changed your modus operandi. In your first go you asked all these folk and they said no. So you came up with a new system, but you thought: 'We're not going that route again. We're just going to whack it out and then we'll do the exposure draft.'

Mr Bergman—Well, we did not just whack it out, because the government made an announcement in December that it was going to amend the Bankruptcy Act to incorporate provisions that would replace division 4A. As soon as we had some initial draft of what that might look like, we convened a workshop to consider that draft and to get some feedback on it before we finalised the draft.

CHAIR—But this whole process began a long time ago, didn't it? When did it begin? In the nineties?

Mr Gallagher—The task force reported in January 2002 and that followed press in, I think—

CHAIR—We will do a time line. What date was the task force established?

Mr Alderson—The task force was established on 22 March 2001.

CHAIR—And it reported?

Mr Alderson—It reported in January 2002.

CHAIR—The reform forum was established when?

Mr Gallagher—The consultative forum was established in 1996—it is an ongoing consultative forum.

CHAIR—So there was the report of the task force and, as a result, there were proposals put forward for comment—an issues paper.

Mr Gallagher—Correct; in November 2002.

CHAIR—The date of the issues paper was November 2002. When that was scrapped or replaced or whatever, what date did we see a replacement for the issues paper?

Mr Gallagher—The government announced a revision in December 2003.

CHAIR—But something must have happened.

Mr Bergman—In July 2003 we released the paper for consideration by the consultative forum—and it was considered on 29 July 2003—and that was a much expanded forum.

CHAIR—What was that document?

Mr Bergman—It was still considering amendments to apply family law principles in all bankruptcies. It was similar to the issues paper of November 2002.

CHAIR—Was it an amended issues paper?

Mr Bergman—It was more an expanded issues paper, as I recall it, specifically to promote discussion at the meeting that we held in July 2003.

CHAIR—The expanded issues paper was in July, and on 29 July the consultative forum saw that?

Mr Bergman—Yes, and other people whom we invited specifically to that meeting.

CHAIR—Such as?

Mr Bergman—Family law stakeholders, like the Family Law Section of the Law Council. There were groups like Relationships Australia. We could give you a list of who attended.

CHAIR—Thank you. It was an expanded forum. What did they say? They still did not like it?

Mr Gallagher—They still did not like it. There were ongoing concerns.

CHAIR—We are up to July 2003. What happened next? We developed 'tainted property'.

Mr Bergman—After that meeting we started to prepare what we might put to the government, and during that phase we sought advice from the Australian Government Solicitor on constitutional issues.

CHAIR—You had not done that before?

Mr Bergman—No. This was the first point at which we were approaching definite proposals to bring to the government.

CHAIR—The Australian Government Solicitor said, 'You've got problems constitutionally'?

Mr Bergman—That is right.

Mr MURPHY—Madam Chair, if it helps you, I put a question, No. 1552, to the Attorney-General on 3 March 2003. The reply was published in *Hansard* on 7 October 2003. It states, inter alia:

The Government has introduced changes to bankruptcy law aimed at preventing people using bankruptcy in an improper way. The Government also released an issues paper on possible further changes to bankruptcy and family law to prevent high income earners from avoiding their obligations to pay income tax. The issues paper was open to comment until 20 February 2003.

Also, the Insolvency and Trustee Service Australia … and the Attorney-General's Department … have recently finalised consultations with interested stakeholders regarding the proposals set out in that issues paper. ITSA and AGD are considering the views put forward during the consultation process and will brief me in the near future on options to progress this matter.

CHAIR—What was the date of that?

Mr MURPHY—The reply to that question appeared in *Hansard* on 7 October 2003. I placed a follow-up question in relation to 1552 on the *Notice Paper*. The Attorney-General said:

The recommendations made by the Joint Taskforce which examined these issues and the suggestions for change put forward in the issues paper released in November 2002 are complex and required sustained discussion with a wide range of stakeholders in order to provide informed advice to Government.

Why did the A-G reply in that way? The reason was that I had asked the A-G why it had taken the Insolvency and Trustee Service Australia and the Attorney-General's Department since February 2003 to brief him on options to progress this matter and whether he would introduce

legislation to ensure that the individual who had been bankrupted on 12 occasions could not ever be declared bankrupt again—if so, when; if not, why not. The reply was, 'I intend to introduce legislation aimed at preventing anyone from using bankruptcy in an improper way.'

CHAIR—What was the date of that?

Mr MURPHY—If it helps the committee, it was published on 3 March this year, and that has led to this legislation.

CHAIR—I think it is good that you have got some of the stuff out, but the long and the short of it is you did not go to the Australian Government Solicitor to ask about the constitutional problems until July 2003.

Mr Bergman—I think September would be more accurate.

CHAIR—So in September you saw you had constitutional problems, and you went away and came up with 'tainted property'. You put that forward to government when?

Mr MURPHY—Some time after March this year.

Mr Bergman—In December 2003.

CHAIR—I have just one quick question with regard to Mr Murphy's concern about the barrister who bankrupted himself 12 times.

Mr Gallagher—It was not a barrister.

Mr MURPHY—He is a pensioner these days.

CHAIR—What was he at the time?

Mr Gallagher—I think that person has always been a pensioner, but I am not sure about that. We provided information about the occupations of those repeat bankrupts and, to the extent that our information provides it, their previous occupation. But that person was not a lawyer.

CHAIR—What was he, John? You are an expert in it.

Mr MURPHY—I was not able to find out his occupation other than that he is a pensioner.

CHAIR—If he was a pensioner and he was obliged to pay tax, he must have had some income.

Mr Gallagher—I do not know that he had a tax debt.

Mr MURPHY—Getting information out of A-G's and the Treasury has been like pulling teeth.

CHAIR—Mr Gallagher, do you know how he earned his income?

Mr Gallagher—My understanding was that he was a pensioner, and I am not sure that he had a tax debt.

Mr MURPHY—I have placed a follow-up question to that one on the *Notice Paper* to try to get the origins of the occupations of these people who are now classified as pensioners.

CHAIR—That is a very good question. I just have one question, and then Dr Washer wants to ask a question. So, in December 2003 it went to government and then the exposure draft came out. On what date?

Mr Alderson—It was 14 May 2004.

CHAIR—Was there any consultation between December 2003 and 14 May 2004 with your consultative forum, expanded or not expanded?

Mr Bergman—There were three occasions. Shortly after the government made its announcement, we had a meeting of the consultative forum to explain the changes but not to discuss them. We convened a workshop on 4 February 2004, following a desire expressed by the forum members at that December meeting, to present and consider an early draft of this legislation. We spent the best part of the day discussing it with the parliamentary drafters present. On 9 March 2004 we had another meeting of the consultative forum, at which we talked at a fairly general level about some possible further changes, which have now been reflected in the exposure draft.

CHAIR—What were the further changes?

Mr Bergman—These were the changes to introduce the tainted purpose test.

CHAIR—So that was when the tainted purpose test first appeared?

Mr Bergman—There was always this concept of tainted property, but we introduced an additional requirement that that transfer had to occur with the purpose in mind.

CHAIR—When you say there had always been a tainted property concept, that came in later?

Mr Bergman—Yes.

CHAIR—After you dumped the first lot?

Mr Bergman—That is right.

CHAIR—Because it was unconstitutional.

Mr Bergman—Yes.

CHAIR—Did those people express to you then that they were concerned about the legislation? I think the Law Council of Australia, which took part in your workshop, indicated that its taking part in the workshop did not indicate it was giving support to the legislation.

Mr Bergman—That is correct.

CHAIR—So you were still getting resistance from the people you were consulting?

Mr Bergman—That is correct.

Dr WASHER—We had evidence yesterday that private creditors, other than the ATO, get a pretty fair deal with the current laws. It was suggested to us that the problem was mainly with the ATO and the barristers and legal people who are involved in that. A problem relating to that was the determination of insolvency, or deeming when someone was insolvent. A suggestion was that, if someone failed to lodge a tax return, that would be deemed to be the time they became insolvent. Would that have solved some of these problems we have faced historically with getting money from these people?

Mr Bergman—As I understand it, the proposal that you discussed yesterday was to create some form of an act of bankruptcy that could take the commencement of the bankruptcy back to the time when they failed to comply with these tax obligations.

Dr WASHER—Yes.

Mr Bergman—One of the possible adverse consequences of that is that, under the Bankruptcy Act as it stands at the moment, property which is available to pay creditors is property which is owned by the bankrupt at the time the bankruptcy commences. So you could actually find that you are undoing a lot more transactions than you would be under this exposure draft bill if that were accepted in that form. If we were asked to consider those sorts of proposals further, we could do that. There may be ways of addressing those sorts of concerns as well. That would be our initial concern with doing it that way. The idea of deeming insolvency as a result of failing to comply with some obligations or failing to take some certain action—

CHAIR—It would be known as a special act of bankruptcy, as it was described to us.

Mr Bergman—Yes, although my understanding was that the submission had two elements to it. There was the special act of bankruptcy, which related to when the bankruptcy commences, but there was also the notion of deeming insolvency for the purposes of applying the existing section 121, so it would actually make it a bit easier. I suppose to some extent we would have to say that that could be part of the answer to the problem because it is reflected in the way we have drafted the current exposure draft.

Dr WASHER—Would we have caught these people who were defrauding the ATO if we had done that? I know there are complications in that; I comprehend what you said. Would we have solved the problem by making section 121 of the act tighter?

Mr Bergman—If the act had always been written in that way, we may have. We may have also caught a lot of other people.

Mr Gallagher—That is assuming that the person's failure to lodge the tax return was within that five-year period. It is still possible that, if the person always had their property in another entity and, for example, 10 years later they failed to file a tax return—

CHAIR—Yes, but you are talking about going under section 120. We are talking about section 121, where the intent is to avoid tax, or rather to avoid your creditors.

Mr Bergman—But that still requires a transfer of property and it does not apply to somebody who has chosen to build up wealth in somebody else's name. That is, they have never actually transferred property to that person; they have just bought it in that person's name.

Dr WASHER—To flesh this out a little more, if that were so—and it would have problems, as you say—you could still claw back beyond that period any transfer of property that would be perceived, at least, to avoid tax or avoid payment to the tax office.

Mr Gallagher—If it were a section 121 application, there would have to be proof that it was done to defeat creditors. To use the clawback provisions, 121 would still require proof that it was done to defeat creditors.

Dr WASHER—I agree. But the evidence given yesterday by various groups was that, as far as private creditors are concerned, they do not perceive a major problem in the current act in accessing money. It seems that the tax office is the major problem, and I think that is what we are addressing as a major problem here; hence the need to change the act as such. Obviously when you are bankrupt you do not lodge a tax return, and if you do not lodge a tax return we deem that you are insolvent and that that is the reason why you did not lodge one. We would still have a clawback period of two to five years before that. I would feel more comfortable with that than with a period going back to almost the day you were born, with there being no time limitation. I have only seen what we call tainted property with the Proceeds of Crime Act. As you know, in various states, including WA, if we perceive that you have gained property from criminal activities we confiscate that property. That is a pretty dramatic step. As I think you said, Mr Gallagher, we do not really want to have bankrupts considered as criminals as such. In reality, that is what we are aligning them with.

Mr Gallagher—I do not know that I would agree that the current provisions are about regarding bankrupt people as engaging in criminal behaviour. They are about ensuring that the creditors get access to the debtor's true wealth. The provisions, whilst they arose, as we know, from the bankrupt barristers cases, are not directed at the tax office only as a creditor. They are endeavouring to address, if you like, a fundamental flaw that is exposed by those practices in the legislation, where a person can put their assets beyond their creditors, whoever their creditors are.

CHAIR—Aside from the Jodee Rich case, have you had any examples of creditors who have come complaining to you, saying this had been used? The evidence from the practitioners was that it actually works quite well. I asked this question yesterday. What this legislation effectively does is transfer risk from creditors to the family of the debtor. There is no earthly reason—in my philosophy, anyway—why creditors should not carry some risk. That is the nature of doing business. The market adjusts the amount of risk you take. I would much rather the market do that

than try and pre-empt the market. That is a philosophical question. I do not know whether you can address that.

Mr Gallagher—I am not sure whether I should debate a philosophical question, other than to say that I think a lot of the commentary on this is about certainty—and that is accepted—but it is not the case that the bankruptcy law is there to enable people to avoid their creditors. It seems to me that we always run into a problem with these time limitations. That is a fundamental flaw. People can work around them. These reforms are endeavouring to address that fundamental issue.

CHAIR—We have just established a way in which you can get around these very provisions, by having a second transfer. We established that this morning.

Mr Gallagher—As David said, it would be interesting to look at those but I think there are some issues about, for example, preference payments following that and whether you would restrict that to the tax office because other acts of bankruptcy that relate to actions by a creditor to recover property require a lot more than the creditor asserting that they are owed a debt. The current requirement to file a creditor's petition is that they have to have given the bankrupt or the debtor the opportunity to respond to the claim.

CHAIR—It is usually done by default judgment.

Mr Gallagher—Yes, and default judgment in itself is not sufficient for a creditor's petition. It requires a bankruptcy notice to be issued.

CHAIR—That is right.

Mr Gallagher—So there are some issues about whether—

CHAIR—This would be your first port of call.

Mr Gallagher—If you relate it back in the way it was suggested I think there would be some real issues about the bankrupt having had an opportunity to respond to the creditor's claim.

CHAIR—An examination order is always a good idea, too, isn't it?

Mr Gallagher—If there is a creditor's petition, do you mean?

CHAIR—Yes—very useful, exceedingly useful.

Mr Gallagher—Yes.

CHAIR—I think we are going to have to move on. What we have done is essentially useful and we had to do it. I think we are going to have to ask you to come back again. I am sorry to have to do that to you but I think there are many issues that we have opened up that we need to talk about some more. Thank you very much for your candour and forthright evidence this morning. It has been enormously helpful. We share a purpose: we do not want people utilising artifices in the law to achieve outcomes which are totally unfair and dishonest. Equally, we want

to look after and protect individuals who can be hurt by legislation in ways that we do not intend.

Mr MURPHY—Mr Gallagher, I note in your submission tabled today but dated yesterday that the provisions in the exposure draft have been drafted to provide a benefit to creditors generally and are not specifically aimed at improving the position of the Commissioner of Taxation. Herein lies the discussion.

CHAIR—We made a jump, didn't we? The task force identified it and then what seems to have happened is that good minds have looked at it and said, 'Hey, this is a general provision which other people could utilise.' But I do not know that you took evidence that it was happening, did you? Do you have any empirical evidence of it happening?

Mr Gallagher—Do you mean are the creditors being avoided? No.

CHAIR—You looked at a loophole and said, 'I think we will shut it,' but you did not have any evidence that it was actually being used, except for tax. Everybody has said, and we are saying it too, that the tax office did not act with expedition. They need a new set of processes to make sure it does not happen again. But that is an aside. Thank you.

Mr MURPHY—I would like an answer to the question as to how often section 121 of the Bankruptcy Act has been used as a means to recover property transferred by the bankrupt prior to bankruptcy. I know from the answer to one of my questions that it was used in the case of John Cummins QC—or formerly QC.

CHAIR—We heard evidence from other witnesses yesterday that it had been used quite a lot. But ITSA probably has the best records.

Mr Gallagher—We would not be the only ones that apply. The Official Trustee may apply but registered trustees typically may apply as well. We will endeavour to obtain that information from both the Magistrates Court and the Federal Court.

CHAIR—That would be super.

[10.50 a.m.]

BRADING, Mr Richard Andrew, Member, Australian Financial Counselling and Credit Reform Association

PENTLAND, Ms Janet Kay, Chairperson, Australian Financial Counselling and Credit Reform Association

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Ms Pentland—I am the chairperson of AFCCRA, the national association of financial counsellors, speaking to our submission. I am also a practising financial counsellor in Melbourne.

Mr Brading—I am a member of AFCCRA and I am also the principal solicitor of Wesley Community Legal Service in Sydney.

CHAIR—Thank you very much. The committee received your original submission and authorised it for publication. We have a supplementary submission that was provided this morning and I would ask that a member move that we accept this supplementary submission.

Dr WASHER—It is so moved.

CHAIR—We might also accept those two pages we received from ITSA as a supplementary submission. Would you like to move that one too?

Dr WASHER—So moved.

CHAIR—It is so authorised. Would you like to make an opening statement, Ms Pentland?

Ms Pentland—Thank you. Firstly, we would like to thank the committee for the opportunity to come along and speak today. We represent the vast majority of bankrupts, who are low-income, low-asset bankrupts. We understand—and it is stated in our submission—that the vast majority of the people that we see will not be affected by this legislation; however, we do have some concerns. I would like to state publicly that AFCCRA, and financial counsellors generally, strongly support the intention of the bill, and we congratulate the Attorney-General on having the courage to take on the vested interests that we believe do lead to some abuse of the Bankruptcy Act. Because our sector—

CHAIR—Can I stop you right there; would you mind telling us what you perceive is the intent of the bill?

Ms Pentland—As I understand it, the intent of the bill is to stop people misusing the Bankruptcy Act and family law in some instances to avoid paying their creditors—to avoid creditors having access to assets and income which a reasonable person would assume are in fact

the income and assets of the bankrupt. Clearly, these sorts of practices are not usually employed by our client base. Our client base have neither the income nor the assets and they certainly do not have the capacity to pay lawyers and accountants to set up the sorts of schemes that I think the bill is intended to address.

However, what does affect our constituency is when high-profile bankrupts—and this is a very small number of bankrupts—come to the attention of the media and bring the whole of bankruptcy into disrepute, and we believe that that does have an impact on our constituency of low-income bankrupts. That is a shame, because I think that by and large the bankruptcy system in Australia works well; it works in the interests of the creditors, debtors and Australian society as a whole—because it does not advantage society to have a lot of people who are insolvent but not able to make a fresh start. So it is on that basis that we strongly support the intention of the bill, and we do congratulate the Attorney-General on addressing these issues.

CHAIR—I am still not quite sure what you think is the intention of the bill. You say, 'The system works well'—

Ms Pentland—It works well for our clients.

CHAIR—but your clients are poor people and therefore they do not use it, so you are assuming that the intent of the bill is to hit high-income earners, not low-income earners.

Ms Pentland—Yes. From the media releases that have come out and from the statements that the Attorney-General has made, we understand that that is the intention. However, we do have a concern that there is nothing in the bill that specifically defines that—so that is a concern that we have.

CHAIR—It is the 'that' that I am trying to get you to define.

Ms Pentland—Okay.

CHAIR—I want you to tell me what you think the bill should be saying, because at the moment it will apply to your clients as much as it will apply to the people you do not like.

Ms Pentland—Indeed. I guess that takes us to the submission that we have made. The provisions in this bill will have a minimal impact on our client group because the vast majority of our clients do not have an income or assets that would come into contention.

CHAIR—Do they have a family home?

Ms Pentland—That is where we get to the case studies that I have provided for you today. There is a small number of people that we see—and, when you read those case studies, you will note that in all instances they are about gambling problems. We do see a small number of clients where there may be a gambling problem, for instance, where there is that property. The family home may be put into the name of the non-gambling spouse as a means of protecting it and also as a means of confirming that, in fact, the gambler has used their share of the family property, so to speak, in their gambling activity. That could be impacted by some of the provisions of this bill, and that is a concern to us.

CHAIR—To get an idea of the profile of your clients, are any of your clients in business for themselves at all?

Ms Pentland—Yes. We do have, again, a small number of clients who may be in business. More likely, they will come to us after the business has failed.

CHAIR—Would they be people who might be a husband and wife running a small business, and the family home has been used as the collateral for the capital for the small business?

Ms Pentland—Yes. In fact, I saw a woman yesterday where that was the case.

CHAIR—Sometimes in those cases would there be a case where the husband has provided the money to buy the family home which is used to back up the business, but she has been given an interest in the home?

Ms Pentland—Yes.

CHAIR—And she will be caught by the bill.

Ms Pentland—That is right. I think the case studies that I have provided today do give you a good overview of the sorts of situations that we are dealing with. I am sorry that I have just provided them to you this morning.

CHAIR—That is all right.

Mr Brading—Do you want to read through a couple of those, Jan?

Ms Pentland—I guess I could. In all instances with these case studies I have provided, we are talking about the situation we have just addressed, where it is a husband and wife. In all instances, there are children involved. The income of the families varies quite a lot but, in all instances, it does involve a family home. In one of them, it involves a motor vehicle as well. They all involve gambling. In particular, the latest case study, No. 4—

CHAIR—I am looking at case study No. 1, and you are quite right. After all her hard work, there would be a very expensive court case. She would have to try and prove the property was not tainted—that it was her money that bought the house—and she would lose the lot anyway.

Ms Pentland—That is one of our primary concerns. I am a member of the Bankruptcy Reform Consultative Forum. I have attended all of the meetings that have been spoken about this morning, and at every one of those meetings I have raised this issue: if the onus of proof is put on the person who has the assets in their name, for most of our clients it will be incredibly difficult for them to have the legal resources—

CHAIR—They will not.

Ms Pentland—to defend such an action. So that is a real concern for us.

CHAIR—Obviously you have seen a very big concern for us too.

Ms Pentland—Yes. If you look at case study No. 4, this is a family that I have actually seen where there has been a transfer of property due to gambling. Bankruptcy is not yet involved, but the point that I make with this case study, and it applies to a couple of the others as well—and I am sure this is not an intention of the bill—is that the wife in this instance may well be better off separating from her husband and having a property settlement under family law rather than, as she is at the moment, staying in the marriage and keeping the family together. I feel certain that it is not an intention of the bill to lead to an increase in family breakdown in order to protect property. That is certainly a concern that we have.

CHAIR—A lot of people have made that point.

Ms Pentland—I guess what we are saying is that there are some instances where—particularly where there are not millions of dollars involved and where the property involved is the family home—when that home is in the name of one spouse or the other, there can be good reasons for that being the case. I think these case studies outline some of those reasons. However, in terms of the intention of the bill to address the abuse of bankruptcy, I reflect on high-profile bankrupts like Alan Bond, like Bob Ansett—

CHAIR—This bill does not affect corporate failure. This is about individuals.

Ms Pentland—However, those people did also undergo personal bankruptcy but continued to live the lifestyle that brought the bankruptcy system into disrepute, I believe.

CHAIR—That is exactly why I asked the question of the tax office—to which I did not get a satisfactory answer and still have not had a satisfactory answer—as to why they do not use their betterment tax provisions, where the Commissioner for Taxation is able to go out and assess the lifestyle of individuals and note that they are not paying enough tax and do something about it.

Ms Pentland—However, I think one of the difficulties is where those assets have been transferred quite a number of years ago. For instance, it seems that Alan Bond was able to fund quite a lot of legal defence for himself out of the assets that had been put in his children's name quite a long time ago. Again, that brings the system into disrepute. I am not sure—perhaps there are better minds than mine that will be able to come up with ways of confronting those issues and addressing that abuse. Certainly one of the recommendations we would make is that the onus of proof in relation to tainted property should be on the trustee rather than on the entity that—

CHAIR—The problem with that is that ITSA would argue that that does not really help because, unless they reverse the onus of proof, they do not get the advantage they are seeking. And we have already established today that you are going to have a second transfer and avoid the whole thing anyway.

Ms Pentland—Yes, that is certainly problematic. But my assumption would be that if you reverse the onus of proof then trustees would only go after bankrupt estates where there were significant assets.

CHAIR—They can do that now under section 121, which is why we are so interested in the use of that provision. It is already in the law.

Ms Pentland—Yes, and perhaps those provisions—120 and 121—are the ones that do need to be strengthened.

CHAIR—We have heard that said before too.

Mr Brading—Sections 120 and 121 have been very successful even outside the court system. For example, a few years ago the introduction of notices under section 139ZQ gave trustees power to issue a notice to the recipient of property saying, 'You received this property without full consideration or for a purpose of defeating creditors.' Unless the person who received the property then took court action to set aside that notice there was a presumption that that property could be taken by the trustee. He would then take a fairly straightforward action in the Federal Court to recover it. Those notices have been quite successful, in my mind. It may well be that more use could be made of those notices in the same or slightly modified form than this legislation. Clearly it appears to me that perhaps more use or some finetuning of 120 and 121 would be a preferable course to these provisions.

I have been a lawyer in this area for some years and the complexity of the tainted property provisions is quite daunting. The vast majority of consumer bankrupts and also a lot of small businesses are being advised by financial counsellors who have little or no legal training. For those counsellors to explain the potential problems through this legislation is going to be very difficult. That is going to cause problems in that the counsellors either are going to be providing information that could be erroneous or will be constantly ringing up ITSA seeking clarification on particular things.

We really want a system that is straightforward, that is simple, that the counsellors can understand and can convey to ordinary people who are going bankrupt rather than saying, 'Look, a transfer that may have happened for genuine reasons any time in the past could be set aside. What have you transferred?' People do not remember. A lot of people do not even know in whose name the house or the business or the car is. It can happen for all sorts of reasons. The administration of this, from our point of view, is going to be quite a nightmare.

CHAIR—Mr Brading, I also looked at the question of the competition between the public policy that underpins the Family Law Act to look after children and spouses and the public policy of the Bankruptcy Act to look after creditors. You could say that this law effectively transfers the risk from the creditors to the families of the bankrupt.

Mr Brading—Yes—and the family have no say in that. They have no say in the sort of occupation or the sorts of activities of the spouse. So, in that sense, the rich people are going to be making efforts to quarantine that property and more ordinary people are simply going to be in the situation where a business failure or any sort of financial catastrophe could mean complete ruin. Then you have families without a home and not even a car to get to work. That would be a bigger drain on the public purse. Having that basic level of property so that people can get to work and have a bit of superannuation, a bit of furniture and that sort of thing enables people to continue living a normal life and they can go to work and so on.

If you look at the state debt recovery laws, which are quite draconian, you see that people are in the situation where their wages can be garnisheed so that they cannot live. In New South Wales, the sheriff comes in and takes everything except the kitchen and bedroom furniture.

Those people are then in a crisis and may well lose their job and end up with medical problems, needing crisis housing and all that sort of thing. There certainly is a very strong social policy argument for providing protection for families.

CHAIR—Somebody jokingly said the other day that a wife could perhaps seek an injunction to prevent her husband going to work because it may jeopardise her asset.

Mr MURPHY—Ms Pentland, your submission refers to assets being transferred within families for reasons including to provide protection for children when an addiction to overspending, gambling or drugs may put assets such as the family home at risk. Is that a common occurrence amongst your client base?

Ms Pentland—It is not a common occurrence. The case studies that I have given you today are all actual cases that have come before our sector. I would say that something like 85 per cent of bankrupts are low-income and low-asset bankrupts. They are basically our client base. Most of the people we see are not going to be affected at all by the reform proposed in this bill; however, there is a small number of families that we see where those issues are present.

Our sector has been dealing more with families where gambling is a problem—and it is not coincidental that the four cases studies that I have given you all have gambling as a feature. That is where it is going to be more likely that we will have those sorts of issues. Our sector, with the assistance of our legal colleagues, has been able to work with families regarding a gambling problem, when it is being addressed, to manage risk in relation to family property and enable the family to continue—if that is what the family would like to do—and not break down. However, these proposals do put that at further risk. It seems clear that, where the non-gambling spouse is balancing whether or not to stay in the marriage, it will be an advantage for them to leave the marriage and get a family law property settlement rather than stay in the marriage and try to keep the family together. I think that would be a pity. I am sure that is not an intended outcome of the bill.

Mr MURPHY—Yes, you do say in your submission that the proposed changes could encourage couples to separate.

Ms Pentland—Yes. You will notice that one of our recommendations is that there be some protection. We are particularly concerned about low-income and relatively low-asset people—even with these cases that we are bringing forward. One of our recommendations is that there be some measure of protection of basic goods—as Richard just talked about—that people need so that they do not lose the family home, if it is an average family home, and they do not lose cars that are not of a luxurious value and so on. The current proposals in the bill do not provide that sort of protection, and we would like to see that level of protection if they go ahead.

CHAIR—I think it would be very difficult.

Mr MURPHY—Are there any other proposed changes in this bill that you see would impact on low-income earners?

Ms Pentland—As I say, a very small proportion of our clients will be affected by the bill. If I think about the bill proceeding and how it can be amended, the sorts of things that come to my

mind are: the reversal of the onus of proof, onto the trustee rather than onto the family; some protection of small or average value assets; and that the court would take into account the non-financial contribution of the entity or spouse—I do not think that is clear in the bill as it stands at the moment.

CHAIR—It is something that the court is obliged to take into account, but that is only at the stage of actually getting to a court case.

Ms Pentland—That is right.

CHAIR—It is the cost of trying to defend such a case, of trying to hang onto your family home, that is enormous. In your case study No. 1 the family home is worth $480,000; people might say that that is a lot of money. Yet it really is her life's work that is now put in danger because of the behaviour of the spouse and the way in which the law would operate as between those two people, and $100,000 could go in legal fees without blinking an eye.

Ms Pentland—Yes. It is totally unfair to the spouse in that instance. On your point and in terms of the court taking into account non-financial contributions of the entity, and in our case that would almost always be the spouse, I know that the bill sets that out, but I think Richard has a view about it not taking it into account.

Mr Brading—The homemaker's contribution is recognised under the Family Law Act; it is not recognised in this situation.

CHAIR—That is right.

Mr Brading—So, typically, the wife is at home looking after the children, the husband is at work earning the money to pay off the mortgage and all the bills—he is making all the financial contributions—and in most cases it will be a jointly owned home. At present, in a case of bankruptcy—let us say it is the husband's bankruptcy and he is an entrepreneur or a lawyer—ITSA would say to the wife, 'Your husband's bankrupt and we now own your husband's half. You can buy out his half. If you can't afford it then we'll sell the house and you get half the house,' and she might be able to buy something modest with it. The way things stand with this is that he has contributed the whole thing, and ITSA or a gung-ho trustee will take the whole lot and she will be homeless. So that dramatically changes things for a typical sort of bankrupt spouse and it would be very much against public policy.

CHAIR—Yesterday I gave the example of a panel-beating firm, and these are exactly the things we were talking about.

Mr Brading—The world is full of risks.

CHAIR—That is the philosophical point I raised with ITSA—that is, if you are a creditor and in business you assume some risk. The market adjusts what the value of your risk is. You may be in business and say, 'I'll take a punt on this bloke,' whereas you have spread your risk over another 10 clients, and that is the market at work. But this legislation seems to want to quarantine the creditor from all risk and transfer the risk onto the family of the bankrupt.

Mr Brading—It is interesting to note that the finance industry are not in favour of this, because from our point of view it is credit cards, home loans and personal loans that are the biggest issues for our clients, not tax. For some people it is tax, but easy credit is the biggest problem for most people. The fact that the finance industry are more focused on changes to credit reporting so that they can make more informed decisions about to whom they lend their money in the first place shows that they have no confidence that this will return dollars to them; it will just create a legal morass in which insolvency lawyers will have a field day. What they want to do is say, 'This is the sort of person who is a higher risk,' or a lower risk, depending on their credit history and what they have repaid. They would really rather see that than this sort of law.

CHAIR—Another issue in all of this is that with the tax reforms that we put in place in 2000, with people having to have an ABN and with GST payments and activity statements, it is a lot harder to do what those barristers, for instance, did.

Mr Brading—There are a lot of people who are not in the black economy anymore.

CHAIR—Exactly—although, really, there are still a lot there.

Mr Brading—We have had people contact us and say, 'I've had a business for 20 years and never paid any tax and now all my trade creditors are wanting my ABN and tax invoices; what do I do?' There is still a black economy, but that has certainly improved things.

CHAIR—That is the truth to how those barristers got picked up: there were suddenly other people who wanted to make claims about the GST and services and so on. I would have thought it appropriate for the tax office to have a task force within its own operation that could pick out individuals of high worth—and these were eminent people—and just check what the tax situation is.

Mr Brading—If I could say one thing about the tax office, they are very slow to act in this area. One of the things we find is that most creditors, particularly financial institutions, are willing to look at compromise situations, either formal debt agreements or informal debt agreements that financial counsellors arrange, and that might return them, say, 50c in the dollar, let us say, or even something less, but the tax office is largely very resistant to this. Their attitude is either that you pay your tax in full or they just proceed to enforce. That means the person declares themselves bankrupt, which might mean they get a zero return. They do not have a very commercial approach to the collection of debts and, if this legislation comes in, it is hard to see that the tax office will actually make much use of it anyway. It will mean a lot of money being spent by the tax office to try to recover these assets and I cannot imagine them doing that.

CHAIR—The point was made yesterday that, because it has absolutely no time limit at all, it could stay in the too-hard basket a lot longer.

Mr Brading—The further back you go in time, the more murky the history becomes and the less likely the court is going to be to enforce it. It looks nice in theory but, in practice, it is going to be a law that is rarely enforced, as a lot of bankruptcy laws are. They are just sitting there as a sort of backup weapon that might be used in high-profile cases.

CHAIR—I would like to hear more about section 139ZQ notices.

Mr Brading—Essentially, what happens is that when a person becomes bankrupt the trustee looks at transfers of property over the previous few years. In many cases, there are people who when things were going downhill might have transferred property to a family member—that is the typical situation. In the past, the trustee would need to make an application to the Federal Court to get the property back and the onus would be on the trustee to show that, say, under 121, it was a transfer to defeat creditors or whatever. With 139ZQ, the trustee simply issues a notice in the form of a letter to the recipient and says, 'I'm the administrator of this person's bankrupt estate; records show that you received a house transferred from the bankrupt and, from the evidence available to me, it was a transfer to defeat creditors or within the two- or five-year period without full consideration.'

CHAIR—To use this notice, does it have to be within the two- to five-year period?

Mr Brading—No. Go back beyond that. If it is with the intention, I think, you can go back under 120 even further.

CHAIR—So you can issue such a notice using 121? You can issue a 139ZQ notice—

Mr Brading—Based on either 120 or 121. But the big thing is that the recipient is then stuck with the situation of going to great expense to file an application in the Federal Court to set aside that notice, in which case the trustee then has to respond to that or lose, or the recipient then has to try to settle, which is what usually happens. The recipient receives the notice and goes to see a lawyer. The lawyer says, 'You can either mount a court application, in which case the onus is on you, the recipient, to show that you are not caught by the Bankruptcy Act, or you can settle with the trustee.' So in most cases the person thinks, 'It's going to cost me a lot of money to fight this case and there's a good chance I'm going to lose and then be liable for legal expenses,' and they will try to settle with the trustee and pay some money back. That means money is available to creditors at minimal expense to those creditors.

CHAIR—Is that notice subject to perhaps being abused and used as a try-on as distinct from having an evidence base?

Mr Brading—It is possible. In that event, private trustees are subject to scrutiny by ITSA, and ITSA to scrutiny by government, I guess, and trustees are reluctant to use those as an abusive measure. Normally they will issue those notices only if they think they have a strong case. If they were issued for an improper purpose, then there would be complaints and that would reflect badly on the trustee. So, in theory, it could be a problem but generally it has not been a problem. It has more been the success or otherwise of a trustee when a person who receives property challenges in the Federal Court.

CHAIR—So, once the notice is issued, supposing you go to court to set it aside, does the trustee then have to prove his case or does the person wanting to set it aside have the obligation to prove that what the trustee has said is incorrect? Is there a reversal of proof there?

Mr Brading—You have got me on that; I would have to double-check that.

CHAIR—Could you do that.

Mr Brading—You would really want to ask one of the trustees about that, rather than me. With the people we see who receive those notices we simply look at the facts and, in all the cases I have ever seen, the trustee was in a strong position and we therefore urged them to try to settle with the trustee.

CHAIR—I can see that being a very good mechanism to use in the two- to five-year period because it is a good method of getting access to the asset, which is clearly caught within that time frame. I think it would be difficult to use under section 121.

Mr Brading—To my knowledge, if it is beyond five years the trustees pretty much leave the asset alone. If there has been a transfer longer than five years they would not deduct it.

CHAIR—We might follow that up because I find that—

Mr Brading—The trustees would give you a better idea about the mechanics of that than I would.

Dr WASHER—Mr Brading, I have a nice simple question. Do you feel that the current act is pretty good overall?

Mr Brading—Yes.

Dr WASHER—If there were any sections in the act that you wished to improve, what sections would they be?

Mr Brading—I would get rid of the provision that makes gambling an offence retrospectively, which is something we have not addressed today. It is something that as financial and gambling counsellors we have asked the government about very strongly. That section says that you can gamble legally but if you become a bankrupt and if gambling is a cause of your bankruptcy then retrospectively you have committed an offence and you can go to jail for up to a year. That is one of the many provisions in the Bankruptcy Act that is just sitting there as a sort of backup measure. ITSA says, 'We hardly ever use it but we like to have it there so that we can coerce people into being compliant.' It is there as a deterrent for people who would perhaps intentionally take out loans and go and gamble them straightaway and then declare themselves bankrupt.

Ms Pentland—In terms of addressing the intention of the current reforms it may be that strengthening sections 120 and 121 is a way to go. Further raising the problems that our clientele have—and Richard has alluded to this—because of the way the exposure draft is at the moment, and this point has been made to me by private trustees as well, and because our clientele—the small number of people we will see—are likely to be unsophisticated they are probably more likely to be caught by the current reform proposals than people who do have access to money to pay for sophisticated legal and accounting advice to set up particular structures. Unfortunately—I am sure it is not the intention of the Attorney-General—a lot of our concern is around the people whom I have outlined in the case studies I have given you today being unintentionally

caught. I do not think they are the target of the bill; however, they are probably more likely to be caught than the people that I think the Attorney-General is targeting.

CHAIR—What we found in the last testimony from ITSA is that the barristers' cases identified to them the loophole, if you like, in the act and they have sought to close it for everybody without any empirical evidence that it was necessary. That was the question I asked. We heard testimony from people who are practitioners that it actually works pretty well. There was no great clamouring at the door saying ordinary creditors are being locked out of getting their fair share of assets by people using these contrivances. What was in evidence was the people with high wealth who can afford to pay. I take the point that you make. I had another question, but it has gone out of my head.

Ms Pentland—I would like to make a final statement that our sector does support the intention of this bill. Maybe that intention needs to be proceeded with in a different way, but we do support the intention to stop this small number of high-profile bankrupts who do give an impression to the public that bankruptcy is easy, that people are able to flout its basic premises, because that does bring the act into disrepute and that has an impact on our clients. Most of our clients who do resort to bankruptcy as a last resort have suffered quite a lot before they get to that point, and it is a pity that bankruptcy is brought into disrepute by the actions of a few high-profile people.

CHAIR—Bankruptcy is a status which is frowned upon by this society. If any of us become bankrupt, we lose our jobs—we are out. It is the same with a whole lot of other professions. Everybody who has given evidence is in agreement, and we are in agreement, that we do not believe that bankruptcy should be flouted in that way. That is good public policy, but the issue we are looking at today is that there has been a mighty leap from that intention to the exposure draft, which we today found out went through another manifestation when they tried to make bankruptcy law operate on principles as does the family law. That is out the door as it cannot be done constitutionally because too many people complained about it. We are now looking at this concept, and fundamental to this concept is tainted property, which is deemed to be tainted and then has to be refuted. That is the essence of the bill.

Ms Pentland—It is.

CHAIR—It is that issue that people such as you find the way it could impact on, in my example, the panel beater and your example of the case studies, which is not seen by the people giving evidence to us as being desirable public policy.

Ms Pentland—I would agree with that.

CHAIR—Mr Brading, I thank you very much for bringing section 139ZQ to our attention, which we can do quite a lot of work with. I thank you both for attending.

Ms Pentland—Thank you for the opportunity.

[11.28 a.m.]

HART, Mr Michael James Patrick, Managing Principal, Cleary Hoare Solicitors

CHAIR—Welcome. Mr Hart, we have received your original submission and two supplementary submissions and have authorised them for publication. Would you like to make an opening statement?

Mr Hart—I thought I only put in two submissions.

CHAIR—I thought it was two, the second one being dated 17 June.

Mr Hart—No. I thought one was dated 26 May and one 31 May. Maybe I did make another submission. My apologies.

CHAIR—I have one dated 17 June, and we also have one from 16 June.

Mr Hart—Maybe I was looking at the dates of my drafts. I apologise. Nothing may turn on this confusion.

CHAIR—No, except that we want it to be properly protected evidence. We have got three: one dated 31 May, signed by you; one dated 16 June, received by us on 18 June, and signed by you; and the last one is the original, which is signed by you. All three have now been received into evidence and authorised for publication, so they are now protected documents.

Mr Hart—Thank you. I will try not to labour the points that are obvious but I need to mention a couple to put things in context. Obviously, starts and expansions of business are dependent upon many things, including managing risk. Risk historically is managed by a mixture of insurance, limited liability and asset protection. Insurance, as you probably know, is not always available; it is often too expensive and, even when it is taken, it cannot be relied upon totally. I will go to an example of that later. The reason I make that point is that it is reported in the press as being stated by the Attorney-General that protection should be found in insurance rather than in other processes.

Limited liability, which is often confused with asset protection, is a creature of statute. It is over 160 years old. It protects shareholders from the liabilities of the company; and this, in turn, allows the pooling of capital for new ventures and limits the risk to the amount of money put in. It is the plank on which public companies and the stock market exist. Everyone takes it for granted, but without this creation of statute shareholders who invest in public companies could be liable for public company debts.

Asset protection is different from that; it focuses upon protecting particular assets. It is usually or historically done by having assets owned in other names, for example, those of family members, or in discretionary trusts, which are broadly called family trusts. If an asset is held in a trust it is effectively held for family members. The purposes of doing this are obvious: to protect

family members who are not directly involved in the business or to protect sacred assets, such as the family home, against the failure of the business despite every effort to make it a success.

Obviously, a prosperous and fair society needs a balance between the risks of business, protecting creditors of future bankrupts and protecting families of future bankrupts. I am not talking about people who are about to become bankrupt; I am talking about people who intend to be successful and honest and who work hard and are honest but, despite their efforts, become bankrupt. As has been pointed out, and as the committee has acknowledged, the vast majority of people do not seek and nor do they covet bankruptcy—it is a very unpleasant state to be in and very stressful.

It is trite to say that without such balance between those rights there would be less entrepreneurial activity and, one would suggest, less prosperity within a country. It would also lead, as we have seen, to unintended consequences which at times could be catastrophic. I have included some of those in the submissions, as others have in their submissions. One very common example I should perhaps emphasise is that of the subcontractor in the building industry. The subcontractor is at the whim of the head contractor. Many of them have suffered at the hands of the head contractor, without necessarily blaming the head contractor, many times over. In the subcontracting industry they, by and large, do not consult lawyers extensively. It is standard practice for them to have homes in their wives' names. If this legislation goes ahead, that very basic asset protection process will be unsuccessful, but it is an everyday occurrence by everyday people doing everyday things.

To focus briefly on protecting creditors, we suggest that the focus should be on protecting them against abuse of the bankruptcy system or against blatant pre-bankruptcy transactions, as is the current law. As has been pointed out, these points are broadly—I am not saying they do not have deficiencies in them—effectively covered by sections 120 and 121 and by the existing division 4A, which the new provisions seek to supplant.

As you all know, the driver for the proposed changes was a group of New South Wales barristers whose antics have been well publicised—failing to lodge tax returns, removing assets to spouses or trusts—and was emphasised by very limited recovery by the ATO, which has led the ATO to push for changes. However, as we have seen, the scope is much wider than that. The scope claims to focus on high net income earning professionals who divest themselves of assets. It asserts—somewhat doubtfully, I would think—that it is government policy to implement fundamental change to the balance of rights. However, the application of the changes is not limited to professionals. It extends to all people who may become bankrupt one day in all categories whenever they become bankrupt. The existing provisions focus upon blameworthy conduct. At best, the new provisions discard the concept of blameworthiness; at worst, they assume blameworthiness in all cases.

I indicated earlier that I would move to another example in addition to the ones included in our submission. An example in my office over the last few weeks is of a financial planner who, with borrowed funds, invested heavily in a new company float and encouraged some of his clients, with borrowed moneys again, to invest in the new float—whether that was sensible or not is another matter. The company was unsuccessful. As well as losing all his own assets, he was sued by his clients, perhaps understandably. His insurer initially covered him. Part way through the case, the insurer withdrew. Inevitably, the financial planner became bankrupt. I ask

the question: is it possible that the insurer knew that the insured would have to go bankrupt, and did the insurer know that there would be no funding for the trustee in bankruptcy to pursue the claim under the insurance? If that was done deliberately, then the insurer has had a significant win. It has to be pointed out that in major companies, including insurance companies, there is no soul which governs the decisions which are made.

This is not a new instance. I personally acted for this financial planner, and in the early nineties I personally acted for a client who was in the engineering industry where, again, the insurer said, 'We won't cover you. We'll just sit and watch to see how the case goes and then we'll determine whether we cover you or not.' Given the lack of funds available to run the case, that client went bankrupt.

So we have spoken about the drivers for the proposed changes. The reasons I think are a little different. The main reason, as has been pointed out, is the inaction by the ATO over many years—for which, frankly, there is no excuse. It has always had powers under various sections of the tax act to get information, which it these days does from the various law societies and bar associations as to who their members are. One of the reasons is also the reluctance of the ATO to fund the trustees in bankruptcy. I understand that other people have made submissions confirming this point. Against that background, the ATO has sought alternatives. It sought alternatives in a task force which has zero experience in private business and small business, zero experience in the risks of business in the professions and, from where we sit, zero experience in real life. It may be seen—and it is seen by us—as intellectual laziness at its best, or zealotry at its worst.

There are some comments which are consistent with this in the press. In an article in the *Financial Review* on 30 June, Marcus Priest referred to a briefing paper from the Attorney-General. Our office contacted the office of the Attorney-General and sought a copy of the briefing paper. To be fair, it was not headed 'Briefing paper'; the journalist called it that. It was a list of examples which the new legislation purportedly would catch. All of those examples are covered by the existing legislation. All of them, except one, are covered by the existing section 121, and the other example is covered by the existing division 4A. In an article by Mr Robert Gottliebsen on page 28 of yesterday's *Australian*—he had previously written shortly after the exposure draft was released about the deficiencies in the legislation—he said that the Attorney-General's office had pointed out to him that there is an exemption for property transferred at full market value more than 10 years ago.

The exemption is an illusion, for this reason: if I transfer an asset to my wife for full value, then I may not have the asset, but I have the money or I have the right to the money. If I later release the debt—the right to that money—I am caught by the scheme provisions in proposed section 139AM. The release is deemed to be done for a tainted purpose, so the release is ineffective. The exemption, because it has to be for full value, will simply not be relevant, unless my wife can prove that I did not do it for a tainted purpose.

I wish to move to what we regard as four special points, which have been traversed by others: (1) the reversal of the onus of proof, (2) discrimination against married women, (3) discrimination against private business and (4) retrospectivity. The reversal of the onus of proof has been well traversed, it seems, from my listening here this morning. But some points to make are that it does not matter when the assistance is provided by a family member to another, if the

first member becomes a bankrupt 20 or 30 years later, the family member or the family entity must prove that, when the transaction occurred many years before, it was not done for a tainted purpose. 'Tainted purpose' simply means doing things for general asset protection purposes.

If the asset owner cannot prove the absence of that general asset protection purpose then the court may make orders against the asset owner. The legislation uses the word 'may'. That 'may' will be interpreted as 'must', influenced by the circumstances—the court 'must' consider it; it is not a whimsical thing. Many years later, the asset owner will often have extreme difficulty in finding evidence as to the purpose of the transaction many years before. In the absence of such evidence, the asset owner will lose and the trustee in bankruptcy will win. Even if the asset owner wins, he or she will be put to significant cost and pain over a long period. There are two major costs of litigation: one is dollars and the other is a very heavy load of negative energy.

The position can be compared with the report of the House of Representatives Standing Committee on Legal and Constitutional Affairs inquiry into averment provisions in Australian customs legislation. Some of the points that your committee made were that averments did not reverse the onus of proof but simply required certain assertions to be taken as prima facie evidence. The committee identified certain abuses of the system and recommended that certain guidelines for the use of those powers should be introduced. One of those recommendations was that the guidelines should state that only suitably trained delegates of the CEO of the Australian Customs Service should make averments.

Assertions under the exposure draft, with more impact than averments, will be able to be made by any trustee in bankruptcy, without the supervision of any particular person. It is a fact that many trustees in bankruptcy lack relevant experience. We all have to go through a learning process—many trustees are young. As noted, the reversal of onus of proof is worse than an averment.

An example given during ITSA's evidence was of a transfer from a husband to his wife and then from his wife to his daughter or from the daughter and then to the wife. The suggestion was made that the exposure draft will not catch that 'on transfer'. We suggest that that is simply not accurate. Section 139AFA is the section which reverses the onus of proof. Section 139AM relates to the scheme provisions. Section 139AFA(6) states that the reversal of the onus of proof extends to the scheme provisions. So all that a trustee in bankruptcy need do is say that the second transfer was part of the scheme, irrespective of the time gap between the first and second transfers. The burden will then be on the second transferee to prove that the second transfer was not contemplated when the first transfer was made. So, again, the owner of the property on the second transfer is put in the same position as the owner of the property on the first transfer in terms of the onus of proof, but may even be in a worse position in terms of evidence because the second transferee—the daughter—may not have been a party to what mum and dad were talking about. So I think the response by ITSA is wrong.

I will move to discrimination against married women. That appears to have been well picked up by the committee already. A spouse who is separating will still be able to have the benefit of a finance agreement approved under the Family Law Act, I think. I do not specialise in family law, but that is how I read it. A woman who works to hold her marriage together will not be able to have the benefit of such an approved financial agreement. That is not to say that women should

not separate. However, we suggest that there should be no distinction between those who separate and those who do not.

I will move to discrimination against small business. Earlier, I drew the distinction between limited liability and asset protection. What is being taken away is asset protection. Asset protection is used by private business or small business. What is not being taken away is limited liability, which is used by public companies. Of course, it cannot be taken away because our stock market would collapse and our whole system of pooled capital would collapse. The fact is that public companies are not being disadvantaged by this legislation; private business is.

Going to retrospectivity, bluntly put: the exposure draft comprises a retrospective confiscation of property and it should be totally unacceptable. If I may—and I do so with some hesitation—I will compare this with the speech by the Prime Minister to parliament in relation to what were the proposed changes to the parliamentary superannuation scheme. As I understand it, the Prime Minister stated that it was unacceptable that retrospective changes should be made in respect of those who had already become part of the scheme and that changes should be limited to those who later became part of the scheme. I suggest to you that the position of business owners and directors is no less worthy in the context of retrospectivity.

I will go to some other matters. The task force mandate was limited to ATO liabilities. It did not extend to claims for negligence against professionals, and it did not extend to liabilities for trade debt. The task force, of its own volition, seems to have extended its mandate to a general policy review. One is tempted to ask whether the government really does embrace such fundamental change in the balance of risk amongst business owners, directors, creditors and families. The explanatory memorandum at paragraph 16 claims that it does. One is tempted to ask: does the government really embrace unlimited retrospectivity? The explanatory memorandum at paragraph 89 says that it does. Rather, does the exposure draft represent public servants on a frolic of their own?

Banks and other lenders will have two bites of the cherry. Banks lend on the basis of statements of assets and liabilities. Those statements set out who owns what. They will not set out that the borrower owns something which he does not, unless fraud is involved. Now the banks will be able to access other assets, such as prior gifts to children or other family members. Another point is that it will allow trustees in bankruptcy to open closed bankruptcies. They can go back six years from now. Bankruptcy usually lasts three years. It is maybe not a major point, but closed scenarios will be able to be reopened. Broadly, we suggest that the exposure draft equates to fixing something that ain't seriously broke. The Cummins and co. episodes do not represent the norm; they represent an aberration. If some deficiencies exist in the current legislation and if they are identified then precise, necessary adjustments to the existing legislation should be made. On our reading of the submissions, some of them address these points.

With respect, we suggest that the committee should wind back the bureaucratic excess. In some ways, the exposure draft extends the concept of sexually transmitted debt to a stage which means it is incurable. It takes married women back to the situation they were in prior to the married women's property acts, which were enacted in various countries and states in the late 1880s. Prior to that the common law was that creditors of a husband had access to his wife's property. There were exceptions to that. For example, there was an exception if a husband settled

property on a trust for his wife before marriage. This new legislation reverses the position and takes us back to prior to the married women's property acts and even takes away the protection which existed then. Any retrospectivity should be rejected. As we suggest, with respect, it should be compared with the position on the parliamentary superannuation scheme proposals. The reversal of onus of proof should be rejected. We suggest that it is worse than the position in relation to averments, which your committee focused upon.

We suggest that the legislation should go back to the drawing board. Its position should be compared with the entity tax system and the tax value method which emanated out of the Ralph report. After considerable input at a later stage from parties external to government, the government recommended that both matters be referred to the Board of Taxation for further review. Ultimately, the board recommended that neither proposal be proceeded with, and instead made specific recommendations for specific changes to the taxation laws in relation to specific matters, and those changes have been enacted.

In short, the exposure draft extends way beyond the mandate of the task force. It has not been subject to adequate external input. It will obviously have draconian effects if it proceeds, including, as we have said, discrimination against married women, retrospective confiscation of assets and reversal of the onus of proof.

Finally, Mr Gallagher, the CEO of ITSA, pointed out that the New South Wales barristers showed how easy it was to shift assets away from identified creditors such as the ATO. That is like saying how easy it is to burgle. Both are against the current law. Failure to apply the law does not justify changing the law so fundamentally, reversing the onus of proof and changing it retrospectively. There is in fact no major loophole in the legislation; there has been major inaction. We suggest that the exposure draft should be rejected in its concept as well as in its detail.

CHAIR—Thank you very much, Mr Hart. The only area that we have traversed that you have not covered in that excellent address is the constitutionality question.

Mr Hart—It is a bit beyond my capacity. I might comment upon it late at night, but not here.

CHAIR—I turn to the question of there being a loophole. You assert that it really is not a loophole at all. That is a similar question to that which I asked ITSA. I asked whether or not they had any empirical evidence of creditors being denied proper treatment under the bankruptcy law because people were availing themselves of the said loophole. They answered that they had none. Indeed, the only evidence they have of people utilising it are the barristers cases—the Cummins case in particular—and the Jodee Rich case. I think the Jodee Rich case probably concerned them even more than the barristers cases, although that was not said.

Clearly, we need to do something to prevent a Jodee Rich type situation. Of course, at the time he was making his binding agreement there was no insolvency, but nonetheless there was provision to intervene in the family law court. We did not get a test case, because he changed his mind. In such a case as the Jodee Rich case, where there can be an intervention to seek an injunction—an ex parte injunction initially and then a lasting injunction against disposing of assets—you have to prove the intent at that stage, which would be quite hard, I think. In this

area, have you put your mind to amendments that could go into the existing legislation that would make it easier to deal with cases like that?

Mr Hart—No, I have not. I would imagine that, with some practical input by a few practical people, some answers could be found.

CHAIR—I might ask you to put your mind to it. You might care to make us a fourth submission.

Mr Hart—I will try to find the time.

Mr MURPHY—Mr Hart, your three submissions speak for themselves and your oral presentation here today also speaks for itself. Can this committee conclude that you think that the existing law would preclude some of these serial rorters of the system in the past from doing the same thing and putting assets out of reach of their creditors for the purpose of avoiding paying tax?

Mr Hart—Yes, I do. In fact, as I understand it, the commissioner or the trustee in bankruptcy succeeded against Mr Cummins in recovery—

CHAIR—Subject to appeal.

Mr Hart—Yes.

CHAIR—We made that point too. I think the more interesting point about the cases involving the barristers is that it was our tax reforms which brought in the GST that really caught them. Suddenly the GST had to be paid on brief fees and people were claiming it; so there was a linkage and that is how they got caught.

Mr Hart—Yes. I would have thought that in general terms there ought not be any doubt at all—even though it is not for me to judge—that someone who fails to put in a tax return for 40 years would know that a particular creditor is waiting there who is entitled to be paid if they were made aware. In shifting your money elsewhere, you are taking action to defeat an identifiable creditor. I would not have thought that there was any doubt about that if people went to the trouble of putting the case properly.

Dr WASHER—Mr Hart, thank you for an excellent presentation. It was great. You mentioned division 4A of part VI of the Bankruptcy Act. Can you tell us a little more about that? It would not have been used often.

Mr Hart—Yes. It was put in in the late eighties and it is designed to catch a situation which does not involve a transfer of assets or money in the normal sense but is one where, for example, a professional might assist another family member in building up assets, as Mr Cummins did, by passing money across. Passing money across may technically be a transfer of assets but, even if it is not, the money is used to build up assets in someone else's name, and he is not properly remunerated for that. In those cases, the court can say, 'The person who has had the benefit should give some of the benefit back.' It has not been used very much. There was a recent case—I think it is called Birdseye—of an accountant who traded in a company. He did not take

salary for himself; others got the benefit. The court found against the accountant and found in favour of the trustee in bankruptcy. Unfortunately for the accountant, he was hit twice. As I understand the situation, he had to pay his contributions out of the income which he was deemed to have, even though he did not have it, and his family had to part with the assets as well. So it can work but it has not often been used. It has been there since the late eighties, I think.

CHAIR—There are also the betterment tax provisions.

Mr Hart—Which is an assessment process, yes.

Mr MURPHY—In relation to division 4A of part VI of the Bankruptcy Act, in your original submission you said:

The provisions of Division 4A, although existing in the Act for many years, have not often been used. *There has been no demonstrated deficiency in them.*

If that is the case, what in your view is the reason for the low or non-use of those provisions?

Mr Hart—My guess is that it is the reluctance of a creditor to throw money at the trustee in bankruptcy to chase the asset.

CHAIR—The tax commissioner gave us evidence that he spent, I think, a million dollars a year in financing the trustee in bankruptcy to pursue actions.

Mr Hart—I am not aware of what he spends. I did read the submission, I think by the Insolvency Practitioners Association of Australia, which indicates that he mostly did not spend money chasing debt.

CHAIR—He is also reluctant to bring test cases when perhaps he ought to.

Mr Hart—On various matters.

Dr WASHER—In summary, your feeling is that the current act is adequate to address these issues that cause so much grief.

Mr Hart—In concept, yes. There may be others who are more experienced with the detailed operation of them who can suggest some changes, but in concept, yes.

Dr WASHER—To flesh this out, do you think the only real problem we have with the current act is the definition of intent? If there is a deficiency to be perceived, is that the only deficiency?

Mr Hart—I do not think there is a deficiency in the definition of intent. If there is a deficiency it is in gathering the evidence to prove the intent. The reason why evidence is not gathered is that the creditors do not put up funding, if you like, to the trustee in bankruptcy to gather the evidence. I suggest that no matter what happens that will always be the case because creditors will have to make the decision: 'Do I throw more money at this?'

CHAIR—I will ask you the question that I have asked a couple of people. As a matter of public policy, the Family Law Act is designed to ensure that a spouse and children, particularly the children, are properly looked after, and the Bankruptcy Act is designed to look after the interests of creditors. If you are in business, you take risks.

Mr Hart—That is part of being in business. None of us likes to lose but it happens.

CHAIR—That is right. You take various actions, including having subcontractors on building sites, and you say, 'All right, I'll work on this job but I'll lay off a bit of risk by having two or three other customers.'

Mr Hart—Yes.

CHAIR—The market works to do that and you adjust your price according to the risk. What seems to have happened here is that there is an attempt to remove risk from the creditors, so that their risk becomes very much less, but we move that risk onto the family of the bankrupt, therefore we seem to have competing public policy positions. Both are in federal jurisdictions and both are federal laws and the two pieces of legislation are ostensibly in conflict, yet the proposal is to give a judge in one jurisdiction, family law, jurisdiction to determine the risk and rights of the creditors in the competing legislation. It seems to me that we are in a very difficult situation.

Mr Hart—Yes, it is so. It depends on what you rate more highly in policy: the needs of families or the needs of creditors. I would have thought that if families rated higher then it would go to the family law court and if creditors rated more highly, which I would personally reject, it would go to those who sit in bankruptcy.

CHAIR—Thank you very much, Mr Hart. We have received some more submissions. I ask that somebody move that submissions Nos 120 to 123 inclusive be received as evidence for this inquiry and be authorised for publication?

Dr WASHER—I so move.

CHAIR—There being no objection it is so ordered.

Proceedings suspended from 12.02 p.m. to 1.14 p.m.

CHAIR—This hearing of the House of Representatives Standing Committee on Legal and Constitutional Affairs inquiry into new bankruptcy laws has now resumed. Before I call the witnesses, we will hear from Mr Murphy.

Mr MURPHY—Madam Chair, if it would help the committee, I will table as an exhibit my consolidated file of the up-to-date answered questions. There are a number of other questions which I have asked since 13 February 2002 to date still outstanding on the *Notice Paper*. The very top answer in the file, which relates to questions Nos 3580 and 3581, gives you details of the occupations of those people who have been bankrupt on four or more occasions. That information might be useful to the inquiry.

CHAIR—Thank you, Mr Murphy. I accept that as a tabled document. I guess it still does not tell us the occupation of the pensioner.

Mr MURPHY—No, it does not, except that the pensioner, on closer examination, is now described as 'unemployed'. He is unlikely to go bankrupt if he is unemployed.

[1.16 p.m.]

CALVER, Mr Richard Maurice, National Director, Industrial Relations, and Legal Counsel, Master Builders Australia

RITCHIE, Mr Todd, Chief Economist, Master Builders Australia

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

Mr Calver—Yes, thank you. In addition to the material we provided to the committee on the characteristics of the building and construction industry in the initial part of our submission, it is interesting to understand the types of businesses that operate in the industry and why our interest in the exposure draft bill was put before the committee. We understand that just under 25 per cent of businesses in our sector are incorporated companies. About another 10 per cent of the 320,000 to 350,000 businesses registered for GST are trusts. The vital statistic, however, is that almost 50 per cent of businesses registered for GST are individuals. Accordingly, the importance of bankruptcy law is given greater focus as close to 50 per cent of businesses in our sector do not seek to shelter under the umbrella of limited liability.

In discussion paper No. 12 concerning security of payments, the Cole royal commission dealt with problems of bankruptcy, insolvency and bad debts in the industry and isolated how the consequences of these problems are more significant for building and construction industry participants than in other contexts. A number of points were made by the royal commissioner. Firstly, the industry in Australia has quite low capital backing and a heavy reliance on cash flow to sustain business. Secondly, the cyclical nature of the industry means there are periods when more businesses are susceptible to financial problems. There is a problem of payment by one firm which has flow-on effects to others. Those flow-on effects can have serious implications for the many firms in the industry that are financially stretched. Thirdly, project based work means that for significant periods a large proportion of a firm's income can depend on the success of a few companies. The failure of one contract can reduce the company's cash flow to zero. Fourthly, many of the smaller construction companies hold few assets. Therefore if a firm becomes insolvent there are few assets to sell to meet outstanding debts.

None of these factors means that Master Builders supports the deliberate manipulation of the bankruptcy laws. Far from it. What they do illustrate is the rationale for security of payment legislation that has been introduced in a number of states, and the risk profile of the sector's market. We make it quite clear in our submission that we are opposed to manipulation of the bankruptcy and family laws to put moneys beyond the reach of creditors. However, in our view the bill being considered by the committee goes well beyond reforms that target a few who abuse the bankruptcy laws—again, laws that have great cogency in our sector.

In our written submission we make the point that, in particular, proposed section 139AFA creates a presumption that if a trustee in bankruptcy alleges that a bankrupt had a tainted purpose as widely defined in the bill then the relevant party was acting inappropriately. In other words, bankrupts must show that a non-tainted purpose applied in relation to the questioned transaction.

This burden is one that small business will find difficult to meet. One other thing that the statistics I have presented to the committee underline is that this is a sector of small businesses.

Every movement of money or property from a person who later becomes bankrupt is potentially up for question by the trustee in bankruptcy. This basic premise, the presumption in favour of the trustee, is to be upheld unless the recipient of the money or the property can prove that the bankrupt did not make the transfer with an intention to defeat creditors. In our written submission in particular we underline the problem with record keeping for small business and associated family members and entities. As we state in our written submission, the basic retention period for income tax records, which is five years after the records were prepared or five years after a capital transaction is completed, is generally the maximum period during which a person will keep records. Therefore, the law is basically loaded against small businesses, particularly unincorporated small businesses, which operate in the volatile context that has been outlined earlier in my remarks.

Rather than maintain our focus on the negatives of the bill, we also believe that it is important that the original purpose of the interdepartmental working group of stopping the avoidance or evasion of taxation becomes the principal concern. It is on taxation that the working party seemed to have its focus. For example, we make the point in paragraph 5.2 of our submission that access to assets by a trustee in bankruptcy should be restricted at least to the length of time over which the unpaid tax debt of any person was incurred. In other words, there has to be a defined period when the questioning of the trustee in bankruptcy can take place. By this we mean that if a tax debt was incurred seven years prior to the date of bankruptcy then that is the absolute maximum period where the trustee in bankruptcy has the opportunity to pierce the veil of protection of whatever legal devices are used by those who wish to use or abuse the bankruptcy system. It is those sorts of solutions that will more closely fit the operation of any legislation with the purpose for which it is being advanced; that is, to stop deliberate manipulation of the rules rather than what we have with the bill where the net is cast so widely.

We are happy to discuss with the committee our other suggestions for positive change. However, we believe that the current legislation is inappropriate. It is far too widely drawn to properly fix the abuses of the system with which the committee should be concerned. Thank you.

CHAIR—I do not know whether you have heard other testimony that has been given before the committee.

Mr Calver—We looked at the web site for a small period this morning.

CHAIR—The *Hansard* will be available soon. You raised a point with regard to proposed section 139AFA. You said that the bankrupt must show that the purpose was not a tainted purpose causing the property to be tainted. Most of the evidence we have heard to date has reflected on the need for the recipient of the property to prove that the property is not tainted. Very often it is going to affect the family home—the major asset that can be affected in so many of these cases.

Mr Calver—I think I said that the bankrupt must show that there is a non-tainted purpose, but that obviously can be the burden of the recipient as well. It is in relation to what is quite common

in the building and construction industry, say, which is that a small partnership operates with a husband and wife and they both have that burden of proof. It is a reversal of the onus of proof, which I think other witnesses have drawn to your attention and which is one of our principal concerns too.

CHAIR—Mr Hart, a solicitor from Brisbane, gave evidence concerning subcontractors, their liability if the head contractor fails and the ramifications for them; if they are on a big job, sometimes it is difficult to lay off their risk by doing other jobs at the same time. It was also mentioned that the practice of subcontractors is to always have the family home in the name of the wife so as to give themselves some protection of their assets. I have put the question before that this legislation seems to want to totally shift the risk from the creditors to the family, basically, of the debtor. How would a subcontractor, who is going to be in a position of being a creditor himself, view this sort of legislation? Would he see it as improving his opportunity of being paid, or would he see it far more as a risk to everything he has built up?

Mr Calver—The question needs to be answered in two parts. The first is that, as I mentioned, the paper on security of payments proposed by the Cole royal commission—that is, discussion paper No. 12—outlined what it conceived to be the rationale for security of payment legislation. Security of payment legislation has been put in place to protect subcontractors and others who are down the contractual chain so that they can be paid when work is done. That legislation is in most of the states around Australia, and where it is not currently enacted it is being contemplated. In Queensland it is only a bill at the moment.

CHAIR—It is only a bill?

Mr Calver—Yes. Other states have had it for some time—the first was New South Wales, and Victoria followed shortly thereafter. The security of payment legislation is a far more appropriate vehicle for protecting subcontractors, although there is some indication that if many of the clients paid more quickly that legislation would not be needed. For example, if governments, Commonwealth or state, paid on time that would protect the flow of cash down the chain. So there are other market factors that affect that more.

What we say is that those risk factors are built into the market and that this legislation takes it beyond the pale in the sense of opening up any prior transaction, even where the creditors are not foreseeable and where the bankruptcy is not foreseeable. So even where those two possibilities were not foreseen, the person who now has the asset in their possession has a reverse onus of proof: to prove that they received those assets transferred or other property without a tainted purpose. It seems that this is, as described by some other witnesses, taking a sledgehammer to the problem rather than giving some thought to how better to collect tax debt, which is what I think stimulated the bill.

CHAIR—Yes.

Mr Ritchie—I would like to add that we have had some responses from our members, and they are overwhelmingly concerned about the breadth of the legislation. We have had only one concern raised along the lines you mentioned, which is that it could be subcontractors who are on the end of a bankruptcy sale. Overwhelmingly the concern is about the breadth of the legislation.

CHAIR—And that is coming from people who are often going to find themselves as creditors and at risk.

Mr Ritchie—Yes.

CHAIR—That is quite important. Would you like to explain how the security of payment legislation functions?

Mr Calver—Perhaps I will take that question on notice with the understanding that in each of the principal jurisdictions in which it works there are different mechanisms now. New South Wales changed its legislation recently.

CHAIR—So it is not complementary?

Mr Calver—Not at the moment, no. It operates slightly differently in each state. In response to that question on notice, I can also provide you with discussion paper No. 12, which contains an overview of the sorts of factors that we have just put to the committee. I think it is best if I do it that way. If I started talking to you about the way the legislation is structured now, it would be a long and tedious afternoon for the committee.

CHAIR—Is it a pooled payment system?

Mr Calver—No, it is a requirement to be paid on notice by being notified and by serving on the principal a notice to be paid—in certain circumstances, a payment notice. There is a statutory requirement to meet that notice.

CHAIR—What happens if they do not?

Mr Calver—The payment becomes due and payable if they ignore the notice. But we will take that question on notice.

CHAIR—So you could get a default judgment if you wanted to?

Mr Calver—You can get a default judgment, yes, but then in the court that is able to be questioned and you can defend it there. There are certain timing triggers in both the New South Wales and the Victorian legislation which it is critical for the person who is being asked to make a payment to meet. If those triggers are not met, the payment does, as you say, become a default payment. It invests the subcontractor with some statutory power.

CHAIR—To prove his debt, in other words?

Mr Calver—To get a payment. It crystallises that there is a debt due as well.

CHAIR—It would be a proof of the debt.

Mr Calver—On the service of the notice, it is a prima facie proof of the debt, yes. But I think it is best if we set it out in writing for the committee because—

CHAIR—But that would be the critical thing—that the notice is prima facie proof of the debt?

Mr Calver—Yes, it is.

CHAIR—Presumably someone can move to set it aside if they want to.

Mr Calver—There are some complicated procedures about the way in which the notice is or is not valid, involving the appointment of what are known as statutory adjudicators, who adjudicate in these disputes. There is an associated bureaucracy with this legislation which is not widely embraced by builders and subcontractors because it has brought into question a whole range of legal complexities. There have also recently been a series of cases in New South Wales where decisions of adjudicators have been subject to judicial review on a limited number of grounds; however, on these grounds lots of the adjudicators' decisions are now going to the courts rather than just the debt itself on the default basis being challenged there. The processes are somewhat complicated. There is not unanimity of support for security of payment legislation, I have to say. It is partly because of that complexity and partly because of the other issues that I spoke about that would assist the risk profile of the industry—that is, the clients paying on time, particularly large, powerful clients. We are happy to give you a short paper on that.

CHAIR—But large debtors like the Commonwealth or state governments usually contract with a head contractor, not with a subcontractor. I am aware of cases where head contractors will pay subbies on really extended contracts of 120 days or more, whereas they are getting paid on 60 or 90 days.

Mr Calver—That abuse further down the supply chain is what the legislation is designed to cure.

Mr MURPHY—Mr Calver, paragraph 3.5 of the submission of your chief executive officer, Mr Harnisch, on 18 June 2004 mentioned the onerous burden on small business of the new record keeping obligations in this legislation, and you even highlighted that the well-argued clause 139F gives the court extraordinary discretion and that provisions such as clause 139F(1)(bb) would exacerbate the issue of record keeping, earlier referred to in paragraph 3.5 of this submission. Can you go into a little bit of detail about how bad you think that is for small business?

Mr Calver—Yes. That is one of the other reasons I mentioned in my opening remarks that the record keeping in the bill seems to be implied but there is no express provision that records must be kept in respect of proving the matters which will be in contention. On the one hand, wherever in the bill you read about the required proofs, particularly where the onus of proof is reversed, there is no concomitant obligation to keep a record to substantiate that proof, and small business just does not do that. We are drowning in paperwork anyway, particularly with security of payments legislation. We are drowning in paperwork at a number of other levels. I chose section 139F(1)(bb) because what you have to do there is show whether or not the market value of the property reflects the ultimate contribution of the other person or the entity. You can only do that by having records that show whether or not the transaction was at market value. If it was not, it is a matter of what objective proof you might have to show the basis upon which the transaction took place and what other consideration might have existed which would have reduced that

market value. So you might have three or four records associated with this one proposition and, as I said, without a concomitant obligation to keep those records. Yes, it is anti small business. That is the only way to describe it.

Mr MURPHY—Do you think that, if the proposed bankruptcy amendment bill were to disappear, anything else could be done to strengthen existing legislation to protect a creditor?

Mr Calver—We make a couple of suggestions in the submission, which, as you mentioned, was sent to you under cover of our chief executive's letter. Under section 5 in the submission, we mention a number of things. One of the starting points is that assets that have been transferred at market value or for legitimate purposes must be completely protected. We say that the original purpose should be focused on. I mentioned in my opening remarks that one of the natural ways in which to have a time period stipulated in the legislation would be to take in the time period over which the tax debt has inured. In other words, it is tax debts that this legislation—if we understand its emanation—is designed to affect. We also say that maybe the Commissioner of Taxation should be given a look-through power where there is a substance-over-form argument. In other words, in many parts of the tax legislation at the moment where the substantive effect of a transaction is to confer a tax benefit, the tax commissioner can look through the form of some of those to defeat the purposes of the transaction where there is a tax advantage at the other end.

Some legislation emanated a few years ago after some afforestation schemes. In the wake of the case of Federal Commissioner of Taxation v. Lau, legislation was designed to stop those forestry schemes occurring where the form of the transactions really did not make sense but where each legal form was acceptable and the ultimate result was that the taxpayer received a taxation benefit. The tax law has been strengthened in the wake of those cases. The tax law here could be similarly strengthened to look through the transaction so that the substantive purpose of it was identified and the form in which the transaction occurred could be unravelled. There is plenty of precedent for that in the Income Tax Assessment Act.

CHAIR—That is, in a way, a more complicated area because of the way in which self-assessment works these days and the way in which public and private rulings function to affect the mass marketing schemes that you are talking about.

Mr Calver—Yes. On reading some of the case studies, which started this process that delivered the bill to you, the barristers concerned would not have been declared bankrupt if it were not for the debt to the Commissioner of Taxation. If you transfer the 'look through' proposition that I was talking about in the context of the Income Tax Assessment Act to the Bankruptcy Act, but for that debt to the Commissioner of Taxation they could not have gone bankrupt.

CHAIR—One of those cases is in that position but not others. There are other creditors and, indeed, the information that has been provided to us concerning high-profile individuals shows that in 2004, for instance, one barrister has gone bankrupt. The debt owed is $305,000, the ATO debt is $157,000 and the assets available amount to $141,000. If I go back to 2002, seven barristers went bankrupt. The debt owing is $2.4 million, the ATO debt is $1.4 million and the assets available are nil. You can see there has been a change since barristers have been told that if they go bankrupt they can no longer practise. As the tax office have told us, that has been remarkably effective in having people pay up.

Mr Calver—All we are doing, though, is putting other solutions on the table, which seem to us to be far more viable than the bill in its current form. It is terrific to have an intellectual debate about all of the possible solutions but, perhaps cutting to the chase, this is not a solution which we think is acceptable.

Dr WASHER—At the end of the day, what I like about your submission is that you said that the bill should be limited to stopping the avoidance or evasion of tax. What we have heard so far is that generally non tax office creditors have not had a problem, historically, with the current Bankruptcy Act. It has not been a major problem. It needs tweaking a bit here and there perhaps to strengthen it, but basically it has never been seen across the board as a major problem, except through the tax office. We have also heard—and I just want to get your feelings on this—that attacking the Bankruptcy Act as such or changing it dramatically will not probably resolve the problem as easily as some other means, as we have already heard. For example, the fact that you cannot work at the bar if you are bankrupt made more difference than changing the act. If we were going to tweak the current act, without major change for non tax office creditors, what would you do? Have you seen a problem with this away from the tax office? Obviously, you have had dealings with people in the Master Builders Association trying to retrieve money. Are there flaws in the act?

Mr Calver—We have not gone to our members to seek an answer to that question, as we have in relation to some of the other issues. We are not technicians in bankruptcy law. If our understanding is correct, perhaps the rules about preferences—sections 120 and 121 of the act—could be strengthened. We are not sure about the manner in which that would occur and how that might interact with the tax office.

But we do make the point that, no matter the reform, if the ATO or whatever trustee in bankruptcy focuses only on the form of the transactions, rather than on the substantive effect—and that is what the legislation does—then it will ultimately not properly affect tax avoidance. That is the proposition with which I can respond to your question. As to the detail of the reform that is required of the Bankruptcy Act, I think perhaps others—the Law Council and the insolvency practitioners—would be better placed to answer that question.

Dr WASHER—I guess, by the fact that you have not heard major complaints from your own organisation, the act stands pretty well?

Mr Calver—Yes.

CHAIR—I find the most interesting point you have brought to our attention today to be the fact that your members are in a unique position most often—spare the contradiction, but never mind—since they find themselves being disadvantaged as creditors because of a failure of a head contractor, but their own personal assets which they worked very hard as subbies for are at risk because of a piece of legislation that is ostensibly being brought in to protect their rights as creditors.

Mr Calver—Yes. That is a very good summary, Chair. I must also say we have many head contractors who are members as well.

CHAIR—Yes, indeed you do. But the subbie is considered to be a microbusiness: mum and dad struggling—they have the family house, which is the only asset aside from the ute, probably—and the kids. They are doing their bit as good Australians and along comes a piece of legislation which is meant to help them in their creditor situation but in fact penalises them.

Mr Calver—It does the reverse. That is a very good summary; that is really the nub of our evidence.

CHAIR—I think that has been most useful; thank you very much. Would somebody move that submissions 124 to 136, which have just been received, be received as evidence to the inquiry into the proposed new bankruptcy laws and authorised for publication.

Mr MURPHY—It is so moved.

CHAIR—It is so ordered.

[1.48 p.m.]

STORY, Mr John, Law Committee Member, Australian Institute of Company Directors

UPTON, Ms Gabrielle, Senior Policy Officer, Australian Institute of Company Directors

CHAIR—Welcome. The committee has received your submission and authorised it for publication. I now invite you to make an opening statement.

Ms Upton—I thought it might be helpful to outline for members of the committee some details about the Australian Institute of Company Directors. We are a peak organisation. We represent the interests of company directors in Australia. We have a membership currently of over 18,000, and members are from diverse aspects of corporate Australia. In our membership, there are representatives from small and large organisations, from across all industries, and there are representatives from private, public and not-for-profit sector organisations. I think it would be timely to bring to your attention the fact that over 50 per cent of our membership are directors of organisations which have fewer than 100 employees. It is indeed with that in mind that, on behalf of that small to medium enterprise membership, we want to speak to you today.

AICD conduct numerous functions. In summary, our objective is to promote excellence in director performance through both educational and professional development opportunities. Our members are required to comply with a code of conduct. We have a number of policy committees: a corporate governance committee; a law committee, which I manage; and a reporting committee. John Story, as mentioned previously, is a member of the law committee and the corporate governance committee. John comes to you today as a corporate lawyer of some 30 years experience. He is the chairman of Suncorp and a non-executive director of a number of large publicly listed companies. He comes here today to assist me to represent the views of directors, and he brings with him his experiences in corporate Australia, particularly from the perspective of the small and medium enterprise end of our membership.

A lot of technical submissions have been presented to the committee and there have been representations on how the bill will interface with the existing law. In our coming here today it is important that we actually approach this proposed bill from a more generalist perspective—that is, the perspective of our members, particularly directors of small and medium enterprises and businesspeople who are going to be grappling with the consequences of this bill, if it is enacted into legislation.

At the outset I would like to record that we are concerned at the short time that we have been given to comment on the bill. We have been given one month. It really is too short a time to be able to inform ourselves properly of the bill. As we try very hard to keep a voice in the public debate and comment on issues which are of concern to our membership, it does create certain difficulties for associations like ours with constrained resources. We have noticed that this is quite a sustained trend not only at the level of federal government but also at the state level—that organisations are given very limited time to comment on legislation, some of which can have material impacts on the way in which business is conducted.

AICD do not condone the conduct of individuals who fail to comply with their tax and other legal obligations. It is very important for us to put that on the record. We do not condone directors who breach the law. We are not an apologist for directors who avoid their tax obligations. Having said that, we do strongly support the stated policy objectives of the bill set out in the explanatory memorandum—that is, of course, to address the issue of high-income professionals using bankruptcy as a means of avoiding their tax and other legal obligations. We also support the fact that targeted solutions are needed to address that particular issue that has been identified. However, as a number of submissions that have been put to the committee have pointed out, the bill itself is a disproportionate response to that discrete issue which has been identified. It does impact on directors of small and medium enterprises and business people, and that is the issue to which we want to speak today.

We feel very keenly that the bill, as it is drafted, represents a shift from the fundamental principle that people should be able to deal with their assets, except in situations where that behaviour and that dealing is going to impact on obligations to creditors and in circumstances where insolvency is imminent.

We are a free enterprise society, which has brought us many economic benefits. We want to encourage people, surely, to undertake business ventures, where they have calculated the risk and where there is a reward if that risk is rightly calculated. Business involves risk. That is the stated, obvious fact that is sometimes ignored and, we would say, was perhaps not given due consideration in the working up of this bill. That risk cannot be entirely eliminated. With that comes the fact that a certain number of businesses are going to fail each year, and they are going to fail even where there is not dishonesty and even where there is not negligence on the part of those people who run the business or are directors of the company. If they are negligent and if they are dishonest, there are provisions in the existing Corporations Act to cover that circumstance.

AICD considers that it is a reasonable expectation that businesspeople and directors are going to want to transfer certain of their assets to provide for the future wellbeing of their families should adverse circumstances arise. If they cannot provide that level of security to their families, why are they going to go into business? Why should they bother? They are going to expose themselves to risk, with the potential downside of losing all the benefits of their hard work up to that point in time.

Our concern about this bill centres on the fact that it seems to imply that the structuring of an individual's affairs in the manner that I have just outlined is somehow illegal or wrong. However, it is a fundamental principle in Australia that people should be free to deal with their assets, except in the circumstances I touched on before—that is, where that is going to impact on their obligation to creditors or where insolvency is imminent. Obviously, if transfers of property are made in those circumstances, it would be in breach of existing law. The position that I have outlined, we consider, creates a reasonable balance between individuals' rights and those of creditors. This bill is opposed to those principles. It is a fundamental shift from those time-honoured principles upon which members of our organisation have conducted their businesses.

I would go so far as to say, from our observation, that the bill appears to be a populist policy response. I do not say that lightly. This is not the first time we have seen it. It really obscures the opportunity that we have to encourage vigorous enforcement of the existing law and the

bolstering of resources to the regulators to be able to enforce that law. It is very important to get insolvency law right because it does not just relate to circumstances where businesses fail; it actually dictates and creates incentives for people to conduct their businesses in a particular manner. We do require certainty about the operation of insolvency law because it has that impact. I would like now to hand over to my colleague John Story, who, as I said, has had significant experience in the business sector, to talk a little bit more about some of the impacts of this bill.

Mr Story—At the outset, I will say that an extraordinary number of submissions have been made in a very short time. I fully concede there is a certain repetition amongst a number of them, but, leaving that aside, the major industry bodies have all responded. I make the point that there are amongst them a number whom you might expect to be supporting a swing in the balance in favour of the trustees and the creditors. As far as I can see, there has been a consistent voice of objection to the legislation.

CHAIR—Except from the tax office.

Mr Story—Sorry—apart from the tax office. There are some consistent themes, and I think there are probably others who are better qualified to speak at length on those, but I will run through them very quickly. There are the uncertain concepts in the drafting that will lead to difficulties in enforcement. There are some absurd outcomes that may or may not have been intended. There is the impact on the third party property rights. There is an extraordinarily wide discretion to the court, and I do not know what the judges will think of it, but it is almost putting them in the position of an administrative tribunal rather than of a court of law. There is the retrospectivity, and I think the point has been made that it does not contrast well with the statement of the Prime Minister in relation to the parliamentary superannuation arrangements. There is the constitutional basis. Is there a valid constitutional basis? The final point I would make is in relation to this 'tainted purpose'. It is a funny concept to decide the outcome of property recovery depending upon what the intention of the bankrupt was five or 10 years ago.

CHAIR—Or 30 or 50 years ago.

Mr Story—There is almost an inducement for someone at that stage to say, 'My intention was for tax purposes; my intention was for anything other than bankruptcy.' I would suggest that it is almost an unhealthy arrangement whereby there is an inducement on someone to re-create, in effect, what their motives were at some earlier period. There is something a little unhealthy in something which depends purely and simply on what the individual's intention was, especially as he or she is the only person who can answer as to that. Maybe they will swear on the Bible that that was their intention, but it is almost an inducement to breach their oath, and I do not think that is a healthy outcome.

I would like to focus on the core principle of the legislation. Stripping away the anti-avoidance bells and whistles, it is proposed that if an Australian transfers property or pays money at any time, with the main purpose of preventing that property or those moneys from being caught up in a future bankruptcy, and uses or derives a benefit from that property or those moneys then the property or moneys can be recovered in the event of a future bankruptcy. Contrast that with the current position: Australians can deal with their assets as they see fit, and that is qualified only by reference to a relation back period of two years, or if they are insolvent or likely to become

insolvent at the time. We say very simply that we think the current position does represent a reasonable and appropriate balance between the rights of individuals to organise their affairs as they see fit and the legitimate and appropriate interests of creditors.

To our knowledge, apart from the tax office, nobody is saying that the balance is wrong. What is the motive behind the legislation? Where is it coming from? If we read the explanatory memorandum, we come up with the new bogyman—the high-income professional. Paragraph 9 says that the bill is intended to address the issue of high-income professionals using bankruptcy as a means of avoiding taxation. Paragraph 11 refers to the problem of a small but significant number of high-income debtors—typically high-earning fee-for-service professionals. Paragraph 49 refers to high-income professionals divesting themselves of wealth. It seems that the author of the explanatory memorandum is somewhat obsessed with high-income professionals. However, the reality is that high-income professionals very rarely go bankrupt. They have access to high-quality management, they have access to risk assessment procedures and they have access to Lloyd's of London professional indemnity insurance. The people I regard as high-income professionals are simply not going to go bankrupt and they will not be threatened by this legislation.

We do have our aberrant band of Sydney barristers. The fact that they existed is probably an embarrassment to their professional bodies and should be an embarrassment to the Australian Taxation Office. The presenter appearing after us is from the Law Council of Australia. The council has a very good submission, and some very simple remedies are recommended in it. If the concern is about those professionals—the Sydney barristers—then steps can be taken to address that issue. That does not require a huge amount of change to the existing legislation. It requires the presumption of insolvency if tax returns are not lodged, the presumption of insolvency if records are not kept and, if it is an issue about tax liability following bankruptcy, it is very simple to provide that a debtor is not released from his tax obligations following bankruptcy. Specific remedies are available, and the next speaker is probably better qualified than I to address those issues.

We do not see that this legislation is directed towards high-income professionals. To sell it as addressing a major issue related to high-income professionals is not a true representation of what it means. I think the Attorney has referred to high-income earners who become bankrupt, and we probably know who he has in mind, but the fact of the matter is that the problem with those bankrupts is not recovering the assets but identifying the assets.

Those who want to cheat the system will move the assets offshore—and this legislation is not going to bring those assets back onshore. Those who want to work the system will have access to all the best minds in the land. This is very black-letter, tortured law and I am sure there are plenty of high-income professionals who will address their mind to it and find a way through the thicket. I would suggest, somewhat cynically, that this legislation could perhaps be referred to as the 'high-income professional income enhancement act'.

Our view is that the people who will really feel the burden of this legislation are those in small business. As Gabrielle has said, that is who we are here representing. It is the small business men who are at most risk of bankruptcy. They are the ones who will bear the burden of the legislation. It is a dynamic environment. Risk is a part of this environment. Small business men do have circumstances which are beyond their control, whether it is drought or changing

economic circumstances. Even a Woolworths or a Coles Myer can go broke, notwithstanding their best endeavours. There are some businessmen who go broke because they are not good businessmen but, in an economic environment such as ours, risk and the prospect of business failure are factors which they must live with.

You can say they have the corporate veil, they have the benefit of corporation, but I think we all know that, given the requirements of financiers, suppliers and other contracting parties, the company guarantees for directors are inevitable. There is a plethora of legislation that means that the assets of company directors are well and truly on the line. I will very briefly run through a couple of examples. Let us take our middle-management employee made redundant in his 40s. He is not going to get another job. We know that. He can go and live on the beach and live on his investment earnings until the pension takes over or he can go out and give it a go and take on a small business. And there are an awful lot of people in today's world who do take on a small business and inevitably, before they do so, they will enter into some sort of asset protection arrangement. It will not be very sophisticated but it will provide at least some backstop so that, if there is a failure, there is something there to put a roof over their head, help their kids through school and maybe to assist in buying their kids' first house. That is the comfort; that is the security. Similarly, the small business man who is successful looks at the further step, further growth, further advancement. Does he take on the additional risk? He will if he knows that, if it fails, there is something to fall back on. It is our contention that, in the absence of that little nest egg or something to fall back on, people will not take the risk.

The real damage of the legislation is the prospect. It is taking away the security of the backstop in the event that all else fails. The question that small to medium business men will ask is: is it worth the candle? I say quite sincerely and seriously that it is our belief that the legislation will create a major and significant disincentive on the small business men to take the initiative, to move to the next step and to have a go. The current arrangements do represent a fair and appropriate balance between the individual's right to organise his affairs as he sees fit and legitimate obligations to his creditors. If you do not agree with that, you must still recognise that this legislation holds the prospect of a fundamental disincentive to a sector of the commercial community that both the government and the opposition have purported to support. We say: think it through again. It is not aimed at high-income professionals or even high-income earners; it is aimed fairly and squarely at the average Australian who wants to have a go.

CHAIR—This morning, when we were hearing evidence from ITSA, we established that they had moved from desiring to deal with those high-income earners. They had seen what they thought was a loophole in the law and moved to close it without any empirical evidence that there were any ordinary creditors crying at the gates and saying, 'We need assistance.' We have also taken evidence from practitioners in insolvency who say that the current system works very well.

We went through a time line with ITSA, who told us that they began this work in 2001. They went through a phase where they were trying to use the family law principles and apply them to bankruptcy, and that was subsequently found to be unconstitutional by an advice from the Australian Government Solicitor. They then thought up the concept of tainted property, and that is where we are now. I think the evidence we just took from Master Builders Australia was particularly pertinent because we were talking about subcontractors. Here is legislation that many subcontractors fail because their head contractor does not pay them, so along comes

another piece of legislation which would ostensibly help them as creditors and yet in fact threatens everything they have built up as people who have tried to protect their assets by being in small business themselves.

There is the real dilemma and, as I said earlier in these hearings, this bill seems to try to remove risk from creditors and transfer it onto the families of debtors. If you are in your own business, it seems to me it is essential that you acknowledge that all business is a risk. You lay off some of the risk by dealing with a different set of contractors, for instance—your return will be according to the risk you take and public policy ought not to be designed to remove risk, because it is inherent in our free enterprise system. So we have what we see as a bit of a conflict between one set of public policy initiatives and another. We are looking at acknowledging that we all share the desire to prevent people abusing the Family Law Act and the bankruptcy provisions to avoid their responsibilities to all creditors, which includes the tax office, and we are looking at how we can best do that without bringing in this whole edifice which could have so many unintended consequences.

I take your point, Gabrielle, about the shortness of time, but I am enormously grateful that the Attorney-General has asked us to look at the legislation and to allow people to express their views. My question to you is: have you, as the Australian Institute of Company Directors, had time to look at section 121 of the Bankruptcy Act, under which the prosecution of Mr Cummins was successfully taken but is now subject to appeal—so we do not know the final outcome—so that we can get a strengthening of the bankruptcy legislation without penalising so many of the other things that we have all discussed?

Mr Story—The only suggestions I have seen that I think do make sense are those made by the Law Council—and I will leave it to the Law Council to put them in greater detail. I am grappling to understand where the problem is, but if the problem is that our merry band of barristers have failed to lodge their tax returns then there is no doubt it would strengthen sections 120 and 121 to provide that a failure to lodge tax returns be deemed insolvency, because then the anti-avoidance provisions that are contained in 120 and 121 will automatically apply, and that will enable access to the assets that may have been disposed of. That seems to me to address the first issue that is concerning the tax office in relation to our barristers.

CHAIR—The interesting thing, of course, is that, in our tax reforms and with the introduction of the GST in 2000, it was the GST that found these barristers out because suddenly they had to put GST onto their brief fees and other people were claiming the GST back. So they were found out.

Mr Story—It still seems extraordinary, as others have said, that they did not actually get a list of the barristers from the Bar Association and check to see whether they had lodged tax returns.

CHAIR—They did not have to do that; they could have got a common phone book. I guess I can say to you that, when the tax office appeared yesterday, we did not get any satisfactory answers. It would seem to me that there ought to be within the tax office a task force which has the responsibility of observing high-wealth individuals and their behaviour and checking off what happens in their tax returns. There used to be an organisation within the tax office called RATS, which looked after VIP type taxpayers. They were the group that went out—

Mr Story—That does seem to address part of it. If there is a concern about those who remain bankrupt without ever paying off their tax bills then the second suggestion—and I am cribbing again—from the Law Council is that the tax obligations are not relieved as a consequence of the bankruptcy. That goes a little bit further than I am entirely comfortable with. The difficulty I have is that I have not yet seen any evidence that we have a problem to start with. There has been a failure of administration. I think a number of the commentators make the point that the tax office is not prepared to fund the actions to recover assets so a lot of the legislation that we have seen come in over recent years is still untested.

CHAIR—They gave evidence yesterday that they supply $1 million a year to pursue assets. I would like to cover a different aspect with you. It has been said that professionals who cannot or do not incorporate should protect their assets by liability insurance. We have also heard evidence about how an insurer can simply stand back from the case and say, 'We will not cover you. Wait and see how the case goes.' There is one case I know of where indemnity insurance was held from HIH. They were covered by the scheme but the gap would be sufficient to bankrupt a person and of course the matrimonial home can be affected. I wonder if you have thought about the question of liability insurance—also for directors, including public companies, where they can be personally liable and theoretically could be made bankrupt too.

Mr Story—Everybody has risks. Everybody who is self-employed lives with risk. It is part of daily life. I have said that the high income professionals will not be caught by this legislation because they are well organised and the insurance arrangements they take out are stitched up very effectively. I suspect it is the middle and the lower income sectors of the professionals who will feel exposed. Our constituency here today, frankly, are the small businessmen and they feel enormously exposed because they do incorporate but they are caught up in guarantees. Incorporation does not provide a huge amount of benefit.

CHAIR—Under the act as it stands, should an individual who has been a sole trader decide to incorporate and place his assets into a limited liability company, that of itself could be an act of tainting the property.

Mr Story—I think that is right, too. We are finishing up in crazy areas, aren't we?

CHAIR—Yes, I think we are.

Mr Story—I think it is very valid.

Mr MURPHY—You say that the proposed legislation is not for high income professionals. Let me give you some comfort. The Inspector-General in Bankruptcy, Mr Gallagher, appeared before us today and tabled a submission dated yesterday. It said in part:

The provisions in the exposure draft have been drafted to provide a benefit to creditors generally and are not specifically aimed at improving the position of the Commissioner of Taxation.

The provisions also ensure that a debtor who is able to structure their affairs in such a way that they don't own assets personally is no better off following bankruptcy than a debtor who does not have that option.

You can see where ITSA is coming from. ITSA, with the blessing of A-G's and the ATO, obviously believes that this legislation is the way to go. Are you putting to this committee—because you have mentioned the failure of the administration—that you do not see there is any need for any further changes to our bankruptcy laws?

Mr Story—Nothing that I have read has demonstrated that there are any major gaps in bankruptcy law that require legislation of this nature that moves the balance to such a degree. I am not an expert in bankruptcy law. It may well be that, on an evolutionary basis, there are areas that can be improved upon. I think the Law Council submission does touch on some of those. But saying that there is such a major problem that we have to prevent the ordinary Australian from structuring his affairs to provide some comfort in the event of disaster, I cannot see that that is there.

Mr MURPHY—We certainly found during the Cole royal commission that the behaviour of some directors in relation to phoenix companies was pretty reprehensible.

Mr Story—Has the existing legislation been fully tested with respect to them? Again I am quoting the experts, but I gather that Prentice v. Cummins is a case in which the QC who had not filed his tax returns for 45 years was successfully pursued and the assets recovered.

CHAIR—As I said, that is the subject of an appeal.

Mr MURPHY—Yes, under section 121 it is subject to appeal.

Mr Story—In relation to the Cole royal commission and those directors I would be very surprised if the provisions of the existing act, and it has been worked over pretty thoroughly in recent years, are not adequate if the hard work is done in enforcement. Layer upon layer of legislation does not achieve anything unless you have administrators who are prepared to get in there and do the hard yards and pay the legal fees to test it. Simply putting another layer of legislation on top which has very difficult concepts, I think, will provide a lot less comfort than what is there already. This is not good legislation. This is legislation under which it will be very difficult to prove a case; it will be very difficult to enforce. I do not think it is an improvement on the current position.

CHAIR—The one area where everybody was somewhat alarmed was, of course, in the Jodee Rich case, where an enforceable financial agreement was entered into to transfer assets at a period when there was no insolvency. We were deprived of a test case, if you like, because he changed his mind and did not do it. We brought in some changed legislation to allow—

Mr MURPHY—Which is to his credit.

CHAIR—Yes, indeed, it is to his credit.

Mr Story—I am not an expert on that case but there are two issues there: one is what is the impact of the Family Law Act and whether that is effective. But leaving aside that problem.

CHAIR—That is what we are looking at as well.

Mr Story—But if you ask was the disposition of assets made at a time when he was insolvent or about to be insolvent, there has to be an awfully big question mark over that. The whole purpose of the existing legislation is that if the chips are down it is very difficult to dispose of your assets. The reason that financiers will take guarantees from directors is not to delve back into dealings 10 years ago but to ensure that when the ship is going down there are not dispositions of assets to directors. If there are such dispositions made at a time when the writing is on the wall, it would be very difficult to sustain those transactions. What is there is pretty good. If you are in a position where there is a legitimate expectation of insolvency then it is very difficult to deal with your assets, unless you are prepared to open the Swiss bank accounts and to play very sophisticated games.

Ms Upton—I want to address the insurance issue that you raised, Madam Chair. We conducted a survey of our membership about 12 months ago on issues of insurance and there were specific questions about the degree to which insurance was available to them, at what cost and whether in fact it added a disincentive to people to take up directorships or to reconsider their roles as directors. I am talking about directors and officers liability insurance, which might be seen as a mechanism to mitigate the risk that we are talking about that people in business face, and it was illustrated that it is fairly patchy on the whole. Companies that are probably most at risk are those that do not have a track record, that might have an innovative idea that is at the heart of the formation of the company, that are small and that do not have a lot of turnover. They are the ones that find it most difficult to obtain this insurance. We fed that information to the Corporations and Market Advisory Committee, which is conducting a reference into the personal liability of directors. But in relation to your question about what other risk mitigators there are, insurance is patchy. It is particularly patchy for the kinds of people that John and I are saying are going to be most affected by this legislation.

Mr Story—Directors at the top end will get comprehensive indemnity insurance. The quality of that insurance then diminishes as you go down; the quality of the cover diminishes and the cost of the premiums increases.

Ms Upton—It may not even be available.

Mr Story—Yes. For our battling Aussie businessman, whom we are really representing today, insurance is not a prospect. He may be incorporated but his assets are on the line.

CHAIR—I think the serious point is that insurance is not available as a right. You get it if you can.

Mr Story—Yes.

CHAIR—Any questions?

Dr WASHER—No, just a comment. I thank you both for appearing before us. I totally agree with what you have said. It is certainly good to highlight the fact that if you are incorporated banks generally get some guarantee from the directors or the people in the business, so you are exposed. You are dead right: I get the feeling that our bankruptcy act is not broken; it has just not been fully tested by determined people. Another thing you brought out, which is highly significant, is that you always get the soft targets but a very determined and very clever well

heeled and well financed target is almost impossible to get under any legislation. I think we have to learn to live with that reality. They are a minority and to destroy the majority, just for an elite minority who can always find a way out of it, seems a little crazy to me too. That was not a question; that was a statement.

Mr Story—We agree with that.

Ms Upton—Madam Chair, I am wondering if you might be able to give us an indication of the timing. I know that there is the idea that a report will be available from the committee some time in July.

CHAIR—We have been asked to report by 16 July. These are our first two public hearings. We have indicated that we want to hear from the tax office a second time, ITSA a second time and Attorney-General's a second time. As there are no further questions, we thank you very much for appearing today. We are very grateful for that.

[2.28 p.m.]

DALE, Mr Christopher, Member, Bankruptcy Subcommittee, Insolvency and Reconstruction Committee, Law Council of Australia and President, Law Institute of Victoria

FARRAR, Mr Denis William, Treasurer, Family Law Section, Law Council of Australia

FOSTER, Mr Michael, Chairman, Family Law Section, Law Council of Australia

LHUEDE, Mr Michael, Chair, Bankruptcy Subcommittee, Insolvency and Reconstruction Committee, Law Council of Australia

CHAIR—Welcome. The committee has received submissions from both bodies and authorised those for publication. There is a supplementary submission that has been provided this afternoon from the Law Council of Australia. I ask that a committee member move that that be received and authorised for publication.

Mr MURPHY—I so move.

CHAIR—There being no objection, it is so ordered. I now invite you to make an opening statement.

Mr Lhuede—Firstly, thank you for receiving the letter of 30 June 2004 addressed to the Attorney-General. I have asked that that be tabled as part of an amended or supplementary Law Council submission. It deals with a peripheral issue concerning bankruptcy reform which I raised at the Insolvency Trustee Service Australia conference concerning bankruptcy offences. If we are looking today at the manner in which the Bankruptcy Act might be tightened up in certain regards then the suggestions in that letter would certainly be relevant for the hearing today.

The other supplementary matter I would like to add to the written submission provided by the Law Council is a further suggestion for amendment which only really occurred to me in the last few days while I was preparing for today's hearing. That concerns amendments in 1996 to the Bankruptcy Act which remodelled the now 120 and 121 provisions and, I should add, the 122 provisions—the antecedent transaction provisions. What they have done in particular with respect to section 120 is remove a requirement that the recipient of any transfer of property must be acting bona fide—that was the old test. That is no longer a requirement under section 120, which now merely requires that it be a transaction at less than market value. Previously, a bona fide purchaser for value would be otherwise exempt. So that bona fide aspect has been removed. While I have not put this to the Law Council, it is generally viewed that that is a problem in section 120 today in that, as an example, if a person were to pay a debt back to a relative within 12 months of bankruptcy that would not be recoverable under the preference provisions because it is outside the six-month period. However, under the old section 120 there was authority for the proposition that if the recipient of that payment, the creditor, had knowledge of the fact that he or she was receiving a preference over other creditors—that is, they knew the debtor was insolvent at the time and by receiving this payment they were doing better than all other creditors—then it

was still able to be attacked. As an example, I was instructed by the Official Trustee's office yesterday on that very case. It was probably that more than anything that brought this to my attention: that we cannot attack that transaction anymore under 120, and we cannot attack it under 121 because there the test is actually intention to defeat creditors and the intention of the debtor. Of course, the debtor will simply say—

CHAIR—That was not my intention.

Mr Lhuede—It was my intention to pay the debt off. So that is an easy fix, and I would add that as a supplementary point to the Law Council submission. By way of summary of the Law Council's paper, the bill, as you are aware, is broken into three parts: a new division 4A, the family law aspect and, finally, the contributions. The first part—that is, division 4A—has been produced as a result of what we see as an ATO perception of people using bankruptcy law to defeat the legitimate interests of the Australian taxpayer. It is not, in fact, a problem. We say that the case is just not made out that there is a problem, and in our submission we look at some examples and figures, which are the task force figures and the ITSA figures. But to the extent that there is a problem it is a problem of tax avoidance.

We say that, in recent times, tax office practices have changed. To the extent that there was a problem, it should now be fixed. It is not a difficult problem to go off to the respective law societies of each state and ask for a list of all practitioners and find out—

CHAIR—A copy of the almanac would do.

Mr Lhuede—Exactly, and just compare it to who is paying you or putting in a return annually. We understand that that is in fact what has happened in the last couple of years.

CHAIR—Actually, the GST was the most influential thing, because suddenly GST is being paid on fees rendered and people are claiming it back. Suddenly, they say, 'Hello?'

Mr Lhuede—Exactly. It was never a difficult problem; it was more of an administration problem. It has been addressed, as far as we can see. The individual legal bodies—the bar associations and the law societies—have changed their practices whereby practitioners must show cause, if they go bankrupt, as to why they should not lose their tickets to practice. In that regard, to the extent that there was ever a problem, we trust that, to a large extent, it has been remedied. I just make the point that it is a tax problem; it is not a bankruptcy problem. In that regard, the task force report does not identify problems with the current act as it stands. I note that, in the *Financial Review* last week, there was a report that the Attorney-General had released a briefing paper highlighting a number of examples. I have asked to see a copy of that, and I have not yet received a response. I had directed that inquiry to the inspector-general. I do not know if that exists or not, but, if there are—

CHAIR—For your information, we took evidence earlier today from one of our witnesses who said he had obtained a copy of that paper. There was, on his evidence, nothing in that list of occurrences which is not covered by the current law. That was the evidence given.

Mr Lhuede—It is just that, if there is something there which gives examples of where the current law fails, we have not seen it and we would like an opportunity to respond—just to ascertain whether these are problems that would not be tackled under the current legislation.

CHAIR—There are a couple of things that came out this morning in the evidence from ITSA. Going to the origin of how this has developed, it began in 2001. They started to address the problem in their task force. The task force reported in January 2002. The reform forum had been established in 1996. In 2002 an issues paper was put out, and they wanted to apply the family law principles to bankruptcy law. There was an extended issues paper in July 2003 that went out to an expanded forum. The forum still did not like these proposals. They then considered what they would put to government. They sought advice from the Australian Government Solicitor as to whether it was constitutional to do what they preferred—to apply the family law principles. The Australian Government Solicitor advised that there were constitutional problems and they could not proceed. So, in December 2002, they decided that they would have another look at it. On 14 May 2004, the exposure draft of the current legislation was made available. In April 2004, the forum conducted a workshop. I think the Law Council of Australia was present at the workshop but said that it did not want its contribution to the drafting to be construed in any way as approving of the changes. But I asked who dreamt up the concept of tainted property and the evidence from ITSA's witnesses was that they dreamt it up as a response to having failed in their original proposition of being able to apply the family law principles to bankruptcy law. That is how we got there.

I did also ask them, when they made the leap, whether they wanted legislation that would fix up barristers or legislation that covered the field. They said they believed that when they looked at what the barristers had done what this did was to expose a loophole in the law and therefore they wanted legislation to close the loophole. I asked them whether they had any empirical evidence at all of creditors who felt that they were being denied justice under the current regime. They answered that they did not. That is where we are presently. There was a perceived loophole in the law, for which we have no evidence except from the barristers who were really picked up by the GST, and the tax office ought to have picked them up a lot earlier.

I wonder whether you would address a couple of other issues for me that were raised. One is the use of section 139ZQ under the current law, which is the provision that a notice can be given by the official receiver—

Mr Lhuede—I do know the provision that you speak of. I provided a paper to a conference in May on section 139ZQ, which I can make available if that is of interest to the committee.

CHAIR—Yes, it would be.

Mr Lhuede—It is certainly my personal view, which I have learned from many years of practice in the bankruptcy law, that section 139ZQ has not worked. Where there is an antecedent transaction, a disposition of property which might otherwise be recoverable, it allows the official receiver on the application of the trustee to issue a notice. This is a statutory notice to the recipient of the property saying, 'This is a void disposition. Please make over the property or money or otherwise go to court to challenge this notice.' What it sought to do was reverse the onus to the recipient of property requiring them to take some sort of action, otherwise the notice

stood. There were some concerns about the fact that failure to comply is actually an offence and, additionally, charges the subject property.

There are a number of weaknesses in that section. Firstly, it talks about setting aside the transaction at the time of the transfer and you recover the value at that time. Trustees need to be very careful about that. If a transaction took place four years ago, you do not actually want to set it aside at the value back then in a rising property market. You want to set it aside today and claim the capital gain, which you are entitled to do. That is probably the first weakness in it and it is not attractive to trustees in that scenario.

Secondly, the courts have shown that this supposed reversal of onus just has not worked. It has not taken a lot for recipients and bankrupts to turn around and put the onus back on the trustee, if you like. In the usual case where particularly the recipient is a family member, if you look at the most typical transaction, the transfer of the bankrupt's interest in the house to non-bankrupt spouse, while they are still together and a happy family I have never seen a case where they both have not sworn up to the fact that this was done for various other reasons and had nothing to do with insolvency or anything else. Trustees find it very difficult to get over that problem. All you need is to have these two people swear up to the fact that this consideration was given et cetera and the court is quite willing to reverse the onus back on the trustee.

CHAIR—It is precisely the point that one of our members, who had to leave, has made. The question was raised that when you have a particularly unpleasant divorce where the husband, for want of a better term, was forced to make a large property settlement, which he resented, and he just wanted to get back at the spouse and did not care how much it cost or what he had to do, he could say, 'This was all done with the intent to defraud the creditors and make me bankrupt,' and life could be hell.

Mr Lhuede—And the response this morning by the inspector-general was, 'That's not likely to happen often.' Well, I can say—

CHAIR—To the contrary.

Mr Lhuede—that I have a case for the official trustees' office today with that very scenario. Five years after a person was discharged from bankruptcy, a private investigator has forwarded information to the trustees' office saying that there is now a family split-up and they have both filed affidavits in a Family Court proceeding, saying that this property that was registered in the non-bankrupt's name was in fact owned by both of them or intended to be owned by both of them. That was on that basis and they have both sworn to that fact—joint property which vested. It is a clear case of fraud. To say that that scenario does not happen—this is not an unusual case; I see it not uncommonly.

CHAIR—We might have no-fault divorce but we do not have non-angst divorce!

Mr Lhuede—Exactly. In an ordinary case, where the family is still a family unit, as a trustee you can usually expect to see both of them swearing up the same way, and unless you have got some extrinsic evidence it is always very difficult to overcome these matters. You have got nothing to cross-examine the witness on. It is only when you have the scenario of a real falling

out and it gets quite bitter—where each turns on the other in these current cases—that the problem unravels.

CHAIR—This legislation is actually going to exacerbate that situation, isn't it?

Mr Lhuede—Exactly. Albeit that there is this reversal of onus of proof—and that can give rise to real hardships and real problems—in the ordinary course of events we are again most likely to see, in a family unit, a situation where the husband and wife are both going to swear up that this was the intention, nothing to do with insolvency, in which case the onus is squarely back on the trustee. I do not see that it is going to solve the problem.

CHAIR—Of course, once it gets to court, under the exposure draft the court is obliged to look at hardship, but there is no definition of 'hardship'.

Mr Lhuede—Yes, and the inspector-general raised this in answer to some of the criticisms of the bill, but let us look at how the bill has actually been drafted. In our submission we referred to the comments of Justice Hayne in the High Court at a conference about what constitutes good legislation. We have here a conferral on the court of a complete discretion, but a discretion within a defined ambit: the court may only look at these things from A to H, or whatever they are. And then we look at the terms used. There is no definition of the word 'use'—

CHAIR—Or 'benefit'.

Mr Lhuede—or 'benefit'—or 'available for use'. What do these mean? It does not even go so far as to say that if the bankrupt had a lot of use it means A, B or C; it just leaves it open ended. It is not well-drafted legislation from the perspective of a lawyer trying to advise a client as to where they stand, let alone a trustee; what is a court going to do in this scenario? As an example, what we are likely to see, again looking at the standard family transaction of disposition of interest in a house to the non-bankrupt spouse, is the wife being forced to bring a counterclaim to say, 'In fact, I had this type of interest in the house'—the Baumgartner type of equity. That is a whole different section of this bill.

CHAIR—And you have a curious concept in that you have virtually merged the jurisdictions of bankruptcy and family law for these purposes, and the judge who will sit will be a judge of the family law jurisdiction. He or she is then meant to apply a test to value non-financial contribution, which under the Family Law Act has a very high value but under bankruptcy law has no value at all.

Mr Lhuede—Exactly.

CHAIR—How do you marry those?

Mr Lhuede—You cannot; it is very difficult—and that is the real concern. This is where the family law section and the business law section differ somewhat. Our submission is that when we come to dealing with the position of the non-bankrupt spouse we need to be very careful before we grant a statutory carve-out of some interest in the family home and the assets to the non-bankrupt spouse, to the detriment of creditors. We do not think that has been analysed carefully enough at all.

CHAIR—Suppose that, instead of a husband and wife who are married in accordance with our new amendments to the act, we have a same-sex couple, one of whom is dependent within the new definition of a dependent person, and property is transferred to the same-sex couple, who cannot come within the jurisdiction of the Family Law Act.

Mr Lhuede—Correct. We raised that specifically. It is the real problem in granting the jurisdiction. The family law section will differ with us in this regard, but that is the key problem we see on that jurisdictional issue until such time as there is a complete conferral of power on the Commonwealth to deal with all those relationships. And it is any relationship that would be recognised in equity, which means same-sex relationships, de facto relationships—everything.

CHAIR—Brothers and sisters.

Mr Lhuede—Brothers and sisters—anything that equity would recognise. The Baumgartner type of interest means that the problem, in our view, must be dealt with at the federal magistrate's court level; otherwise, we have split jurisdiction and two quite distinct sets of laws. From a policy perspective it is certainly the view of the Law Council that that is unpalatable.

CHAIR—I see that you have a big problem.

Mr Lhuede—Exactly. When we talk about that second aspect of the bill and the statutory carve out aspect, there has been no real analysis of what we ought to be handing out, or what we should be preserving from the creditors for the benefit of the bankrupt and/or his family. There is a general policy consideration about superannuation, and there are quite specific problems which do require amendments in relation to superannuation and bankruptcy. On 16 December the Attorney-General announced that there were to be amendments with retrospective operation to 16 December. That is in train, although we are yet to see where that is going. Things like HECS debts and proceeds of crime are not released. Again, that is not provable, so it does not come into bankruptcy. There has been a lot of individual carving out of niches.

Mr Dale—Civil penalties.

Mr Lhuede—Civil penalties is another one. Chair, you raised the Jodee Rich case earlier. Jodee Rich has no debts that I am aware of. There are claims against him. There is a claim under the civil penalty provisions, but that is not provable in a bankruptcy. They are the sorts of things we need to be looking at in an overall view of what should and should not be carved out before we say, in isolation, 'This will be available to the bankrupt spouse.' The business law section recognises that there are benefits in a carve out in terms of certainty and also justice for the bankrupt spouse. What we say, though, is that any such proposition should be part of an overall review of the general scheme of the act. What is it, from a policy perspective, that the government is going to protect for the bankrupt and/or his family? From what we can see, that analysis has not been done. In that regard, we see the act as rather shortsighted. I do not know if Mr Foster can add something on that aspect of it.

Mr Foster—No.

CHAIR—Mr Foster, can I ask you the following question because it deals with the family side of things. We are dealing with two areas of federal responsibility which are both covered by

section 51. In the family law area, public policy says that we enacted legislation to make the welfare of the child predominant and the child must be looked after. We have the Child Support Act to back all that up and to ensure it. Then over here we have bankruptcy legislation dedicated to looking after the rights of creditors. The two areas seem to be in competition. I have said before that we are shifting the risk assumed by creditors in doing business—where, in my view, there should always be a risk—onto the family of the bankrupt, whom this piece of legislation says we have to look after. So we seem to have a conflict of public policy in those two areas.

Mr Lhuede—The Law Council of Australia recognises that, at the end of the day, whenever we have an insolvency it is a finite pot of gold, which is just not big enough to go around. That is the reality of it. That means that at some stage it is your job as the government to make a decision as to which way that policy decision will lie. You are right: they are very difficult to reconcile and, ultimately, it is going to come down to a question of what weight you will give to each interest. When you talk about the statutory carve-out, that is one aspect. When you talk about the bill and the division 4A aspect and the aspect of putting the risk onto the family unit, we entirely agree with that analysis. What the legislation is seeking to do is say that the family assets are to be available to creditors no matter at what stage they were derived or who put anything into them. They are at risk. It might not be that the trustee can reclaim them, but it opens them up to challenge.

CHAIR—It does open that up.

Mr Lhuede—We say, 'If I'm going into business tomorrow and I have no debts today and my tax is all paid up, why can't I make a decision with my family that we will have that family home so that no matter what happens into the future that home will always be there for the benefit of my spouse who is at home raising my three children'? In my personal instance, my wife gave up a very good career for that purpose. I can then go into business. I will deal with creditors, but they are not being unfairly treated because they know what the situation is. They know I do not have the house, because my wife owns it. Why is it that the creditors in that scenario are being treated unfairly?

CHAIR—They are not. They make a market adjustment to the degree of risk they are prepared to assume in your case.

Mr Lhuede—Exactly. That is the usual scenario. We do see this as an attempt to place the risk on the family unit and expose the family unit's assets to the adventures of the individual.

CHAIR—I gave the example yesterday of an ordinary, struggling husband and wife situation. The husband buys the house and makes the payments. He transfers half the value of the house to his wife. She makes no financial contribution at all. He has a panel beating business. He conducts the business for 15 years, but then the marriage breaks down. The settlement is that he keeps the business and his wife keeps the house. He continues on in business and five years later he is bankrupt. You can reach back to the settlement of that property, to the wife's settlement.

Mr Lhuede—Using that as an example—I know this is on the public record; I do not know how much I should say on the public record in relation to avenues of avoidance—there are very real risks of families deciding between themselves to enter into binding financial arrangements whereby the debtor who is about to become bankrupt keeps property not otherwise available to

creditors, for instance, superannuation, while the wife keeps the house. That transaction is valid under the Family Law Act and would be very difficult to upset under any perspective. But what it is doing is getting property that would otherwise be available to creditors and putting it entirely out of their reach.

CHAIR—That is one of the things we are looking at and one of the things that the exposure draft is attempting to deal with.

Mr Lhuede—That example is not dealt with at all in this scenario, save and except that it does remove—and I think this was one of the questions this morning—financial arrangements from the definition of maintenance orders in division 4.

CHAIR—That is right.

Mr Lhuede—That is probably one way of doing it. Equally, why couldn't the two spouses go to court for a consent declaration to the same effect?

CHAIR—They could.

Mr Lhuede—There would be the same result. Again, if it were still the case, what if it was a genuine—

CHAIR—What they are proposing to do is allow the trustee to intervene, to have standing before the court and to seek an injunction.

Mr Lhuede—I think that was the actual result of the Jodee Rich amendments in relation to binding financial arrangements. The problem you will face is that, even with the current legislation in the example I gave, it is not going to help, because there might be a bona fide marital split-up, in which case it is not done to defraud creditors; it is just a case of the parties agreeing on the property split-up. It would not be unusual for a non-bankrupt spouse who has the care of the children to take the house and for the debtor to keep the business assets, not the cash elements. They might be tied up in, say, the longer-term interest of superannuation. Proving fraud or intention to defeat creditors in that scenario may be difficult in itself.

CHAIR—This exposure draft is not going to assist in that?

Mr Lhuede—It is not even raised. The issue that I have just mentioned is not raised, and it certainly would not be cured by this bill.

CHAIR—Keeping the assets that cannot be attacked in the bankruptcy is a new element. But the family home is basically the essence of what is going to be the main asset, isn't it?

Mr Lhuede—Usually.

CHAIR—Whether it is a huge mansion or a humble bungalow, it is going to be the main asset at issue. I think ITSA was arguing that, by removing the financial agreements from the definition of maintenance, they could be attacked.

Mr Lhuede—The reason they have had to do that is that the present section 123(6), I think, exempts from the operation of section 120 maintenance agreements and maintenance orders. That is defined to include financial arrangements. By exempting it, what you are saying is that if you enter into a transaction it is very difficult to attack it under section 120 if it is a financial arrangement. In that regard, all you are doing is reverting back to this new division 4A and asking, 'Is that transaction otherwise with the intention of defeating creditors?'

CHAIR—What we are saying is that the creditors can have the family house and that the wife and kids can be out on the street?

Mr Lhuede—Basically.

Mr Dale—That is a fantastic result, considering that the case in favour of it was never made out. It is our submission that the task force's apparent need has manifestly not been made out. I have heard with interest what could be described as the shifting sands of justification, described by you as chair, and in my submission it is still not made out. The legislation as it presently exists covers most of the cases, and for the exotics we contend that there may be a need for some minor amendments to the existing sections 120 and 121. Beyond that, the collateral damage caused by this legislation is really quite dramatic and it just does not justify changing centuries of settled law.

CHAIR—Interestingly enough, when the ABA appeared I posed a question about the sort of checks a lender for a mortgage for a house should make as to the antecedent transactions of that house. One submission pointed out that this legislation could be at odds with the whole functioning of the Torrens title system, just to give indefeasible title. I made the point that we could be in the situation where the lender may have to do what is the equivalent of an old systems title search, despite a good root of title.

Mr Lhuede—There is a very real concern, as I understand it, with the banking industry with amendments which are due to come into effect later this year whereby the Family Court will have an extended power to effectively absolve people from responsibilities under mortgages. It is one of the amendments. I cannot refer you to the actual act, but I believe it is enacted but yet to come into force. One of the powers of the court does go so far.

Mr Foster—It operates from the end of this year. There is a 12-month period for the financial institutions to adjust to the legislation, but the legislation passed before the end of last year and comes into operation in December this year.

CHAIR—Would you like to explain it?

Mr Foster—It enables the court to vary the rights of creditors, subject to a range of safeguards, of course. In actual fact, I do not think it will work against the interests of creditors because the court has to take into account the interests of creditors, so it is very difficult to see that a creditor would ever be disadvantaged. It conceivably could be used to shift a liability from one party to another, but I find it almost impossible to believe that the court would ever do that if it disadvantaged the creditor. But if both parties had assets, for example, and it just simply suited the purpose of the court in bringing about a just and equitable settlement overall to shift the mortgage from, for example, being secured against the husband's house to being secured against

what the wife was going to take then so be it. I do find it hard to imagine it would ever go any further than that.

CHAIR—You do not see it being shifted from a mansion to a bungalow?

Mr Foster—No, I do not, or for a secured creditor to become unsecured. It is really inconceivable. Notwithstanding myth and rumour, assessing the assets and liabilities of the parties is the absolute first step in any Family Court process. There is a fundamental element even in consent orders. The court retains its supervisory role and sometimes you have to appear before a judge even with consent orders in order to persuade them that the orders are just and equitable or even that the interests of creditors have been taken into account.

CHAIR—Is that consistent, and did you think it was a good idea to remove voluntary agreements from the scrutiny of the court?

Mr Foster—I am trying to remember what our position was on that. I think we were content with that. It certainly worked well in New South Wales in the de facto relationships arena for quite a long time, and I think we felt that that was a good test. There certainly is a strong argument that supervision is a good idea, but I think we are happy not to have it.

Mr MURPHY—On page 33 of Mr Webb's initial submission, he said:

The FLS is firmly of the view that a party to a marriage breakdown should be able to apply to the Family Court for a property adjustment notwithstanding the bankruptcy of the marriage partner.

The disparate policies concerning this issue are difficult to be reconciled.

The IRC recognises the benefits of a policy that will lend certainty to all parties concerned. To this end the IRC recognises the general policy in Schedule 2 in that it seeks to balance the rights of the parties to the marriage with the interests of creditors. Concern however does remain as to the manner in which the Family Court will assess the respective claims.

What do you propose in terms of schedule 2?

Mr Lhuede—That is where we say that, before you start carving out an interest for the non-bankrupt spouse or other relationships, we ought to be reviewing just what that carve-out should be extended to and how great it should be. Firstly, it is the point I raised earlier. If there are disparate policy contentions, competing policies, someone has to make a decision. To the extent that there are benefits from certainty in setting up a statutory scheme then there is certain merit in that. The problem as we see it under the current system is that there is just no protection for creditors. Also, it really has been done in isolation of what else occurs in the act by way of exemptions from property. I suppose that is the thrust of our argument—that you really need to take it into account with everything else in the act, but specifically the problem we see is that there is no specific protection for creditors. There is nothing preventing a Family Court judge from saying, 'We've got a pool of money here and, quite frankly, the creditors are all banks and big people. Rather than put the non-bankrupt spouse out on the street, we'll favour her.' There is nothing preventing that occurring. It is that concern which we have.

CHAIR—But you are not really putting the opposite case—that you think it ought to go into the Federal Court jurisdiction so that they will say, 'To hell with the wife and kids; the creditors had better have the dough.'

Mr Lhuede—The position today is that the other party to the relationship has equitable rights which they can establish over property—they either can or cannot establish that. That, however, can be a costly and time consuming business. With respect to those costs and the fact that it is often the non-bankrupt spouse who has no resources, subjecting them to this whole bankruptcy regime places real hardship on the family. It is in recognising this that we see there is merit in creating a system where there is a carve-out. So we are not saying that we should not have one. It is just that, if we are going to do it, it needs not only to be done in a wider sense of what should be carved out and to whom, in relation to the whole Bankruptcy Act, but also a proper balancing of the interests of creditors so that their interests are not entirely subrogated to the rights of the relationship.

Mr MURPHY—At 11.5 of your submission, you say:

The LCA is in favour of the proposal ... that the Bankruptcy Act be amended to insert a new act of bankruptcy to apply where a person is rendered insolvent as a result of assets being transferred pursuant to a financial agreement under Part VIIIA of the FLA.

Then you conclude:

... there might be some difficulty in establishing the act of bankruptcy.

Mr Lhuede—Correct.

Mr MURPHY—Do we do it or not?

Mr Lhuede—On balance, I would prefer to see it there, but the reality is that it is a private agreement between two individuals, unless it is made public. I understand the Jodee Rich case came to light because someone from the ACCC read about a house transfer in Column 8. That is how it came to be known. Given that it is a private arrangement, how are you going to prove it? I do not know. There has been a lot of talk this morning about new acts of bankruptcy having relationship back. I do not see that as a remedy to the problem. All an act of bankruptcy does is gives relationship back to the commencement, but you still have to tie that back to the date of the bankruptcy anyway. It is an act of bankruptcy within six months of the date of the bankruptcy, so that is not going to help you. Unless it is a case of making it easier for people to bankrupt debtors, I do not see that we need to amend the acts of bankruptcy otherwise. This is more just a trigger event for those cases where we do not otherwise have judgment debts, but we suddenly become aware of dispositions of property purportedly pursuant to binding financial agreements that you may want to try to get in there to stop them quickly.

CHAIR—You do if you get wind of it; you can go and intervene, if there has been an injunction.

Mr Lhuede—Certainly—if there has been a transfer of property pursuant to it. The problem you have is that sometimes people enter into the transfers but do not register them. They would

still be binding in equity but not necessarily registered. In which case, how do you ever know? But, for those cases where you do have something—

CHAIR—You would know when somebody tries to attack the asset.

Mr Lhuede—Exactly, but by then it is too late.

Mr MURPHY—Is there anything good in the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004?

Mr Lhuede—In terms of division 4A, very little. We actually cannot find anything. The fact is that the division 2 aspect, resolving the family creditor conflict, is a real issue that does need resolution. To the extent that this bill provokes a resolution of that problem, that is a very good thing. I know a lot of my colleagues are very anti this carve-out altogether. The fact remains that the Federal Court in bankruptcy cases is moving towards a non-financial contribution as supporting that Baumgartner type equity. The question is: how long do we wait for that to become established law by way of the courts versus should the parliament be doing something in the interim? That is something which does need fixing. There has been no case made of a problem in 120 and 121. I can take you to a number of very specific issues with 120 and 121 which could certainly help. I think the easy fix would be the one I mentioned at the start, the reinclusion of bona fides. There are potential problems which the Cook v. Benson case, which again no-one has raised to date—

CHAIR—I kept asking for examples of the use of 121.

Mr Lhuede—The Cook v. Benson case is a problem which is not restricted to superannuation. The case predated the 1996 amendments, so it lived under the old law. I acted for the trustee in that and Mr Dale actually acted for the superannuation funds. What the High Court held in a majority I think of 5-1 was that the superannuation funds gave valuable consideration for the payment to it of the $120,000-odd from Mr Benson at a time when he was insolvent. He had been served with demands by the ANZ bank. He immediately trots along and cashes up.

CHAIR—But we are talking about excessive payments.

Mr Lhuede—He had I think $80,000 and that had vested in him. It was cash he otherwise would have had in a bank account and he paid that into three separate superannuation funds at a time when he was insolvent. The trustee claimed that if a person gives the money to a trust he is giving it away; he no longer has it. The trust merely holds it on the trust. There is no consideration. Therefore it is capable of being clawed back under 120. The High Court said, 'No, the superannuation funds promised to hold that money, deal with it and give it back to him many years hence.' The problem which no-one has yet raised in any commentary that I have seen is that the superannuation fund is merely a trust. It is no more and no less. Can a person give money to a trust on identical terms to what is otherwise a superannuation fund and be similarly protected? On the basis of the High Court ruling there is no problem with that.

CHAIR—You mean as long as it is a fiduciary relationship to pay it back?

Mr Lhuede—Exactly. The trust will merely say, 'We will hold this money and invest it for your benefit and pay it back in certain circumstances down the road.' Why is that any different from the very trust deed which the High Court dealt with in Cook v. Benson? I cannot see a difference.

CHAIR—So in Cook v. Benson it was not a superannuation fund—

Mr Lhuede—It was a superannuation fund.

CHAIR—But you are saying it could apply to any trust—

Mr Lhuede—I cannot see a distinction.

CHAIR—of which the debtor is the cestui que trust?

Mr Lhuede—Yes. There was another case before the High Court decision. It was Trevor Newton Small v. the Official Trustee. That concerned a bankrupt in the same circumstances cashing up his money immediately before bankruptcy. But in that case he actually put it into a non-arms-length fund. It was a self-managed corporate trustee. That case you can hit under 121 under the current legislation because the trustee he was a director of was impressed with his knowledge of intent. So you can set it aside. Here, though, it was large public company trustees in Benson which could not be imputed with the bankrupt's knowledge. As long as a trustee invested it in a mutual trust somewhere, who did not have knowledge of the bankrupt's intent—

CHAIR—The exposure draft does not remedy that, does it?

Mr Dale—No, but let us not forget the Attorney-General has said there is separate legislation which will be introduced which will deal with that Cook v. Benson point.

Mr Lhuede—It will deal with the superannuation aspect. It will not necessarily deal with anything else, because it talks about dispositions to regulated funds. We have seen a presentation from the Inspector-General's office on that and I certainly have my reservations about the tack being taken. I think you can fix the problem with several simple amendments. But the superannuation industry has certain concerns: if a public fund is the subject of a claim, where does the money come from when it has to be paid out?

CHAIR—Whose money is it? It is mixed.

Mr Lhuede—It is all mixed. It is resolving that problem that has been causing the headaches.

CHAIR—How does that affect the returns and who owns which returns?

Mr Lhuede—Exactly. Who pays the price and where does it come from? There are issues which I recognise in that regard, but they were not problems which we had previously had difficulty with. In the Cook v. Benson case, as I understand it, the claim was simply going to be paid out of the fund, being the member's nominated interest. I do not see the problems as insurmountable.

Dr WASHER—In summary, the Bankruptcy Act, as far as the Law Council perceives it, is not that bad? It just needs some amendment to sections 120 and 121 to refine it a little better, so to speak?

Mr Lhuede—Certainly.

Dr WASHER—Basically, the ATO's grief—because this is generated from the ATO—would have been addressed if they had been more diligent and more aware and, under the current act, they probably could have successfully prosecuted the people who currently are the reason for this whole change in the law that we are looking at?

Mr Lhuede—If the ATO has a case and feels that it is in a position whereby the government feels that the ATO needs extra protection, you do not need to go through with these amendments. The suggestion we put forward was an amendment to section 153, which states, 'Give the trustee in bankruptcy and/or the ATO a power to go to court and say that that tax debt will never be released.' If there is a problem with people paying or not paying tax, as is the case here, then you can solve that better—as it was put to me—by a smart bomb as opposed to a thermonuclear device. Hit the problem. If it is people not paying tax, there is more than enough precedent under the act as it stands today for discrete government revenues being protected in that manner. HECS debts are not released. There are Crimes Act aspects for general revenue. That goes against the general policy that came out of the 1993 amendments and Harmer, which said that tax will be treated like every other creditor.

CHAIR—It certainly does, yes.

Mr Lhuede—It does conflict with that. We are saying that, if there is such a problem that does need remedying, then we can fix it with this isolated amendment.

CHAIR—On the figures that we have been given from 2002 to 2004, there really does not seem to be a case made out for why the tax office should be specially treated.

Mr Lhuede—No. Our primary submission says there is not.

Mr Dale—There is no case that demands it.

CHAIR—There just is not. In fact, the easier you make it for the tax commissioner, I suspect the 'lazier' he might be about pursuing what is available to him.

Mr Dale—I come back to the point that has been made a number of times today that we should not lose sight of—that is, the issue of compliance is now far less an issue because of GST. We also have the fact that, at first instance at least, the Prentice case was successful for the trustee. We hear that it is on appeal; we acknowledge that. But it is the failure to address a real need that we think just leaps off the page in our submission. One justification that is put forward is that it is said to be necessary to claw back assets which have been devolved away for the use of creditors. We say to that statement, ad nauseam, that the language is so wide that it drags into the equation, by way of collateral damage, a whole lot of ordinary asset protection which, for very good public policy, ought to be there.

CHAIR—How do you argue the argument that is put forward that you have no right to protect assets; what you should do is simply take out insurance?

Mr Dale—I am about to come to that. In dialogue with the Attorney-General he has come up with two points. One is that he has said to me that the reason why this legislation is necessary is to claw back in those assets. I say that, if the existing provisions are not adequate, minor tinkering at the edges of sections 120 and 121 will cover it. Secondly, he says that it is covered by insurance and all of this is an insurable risk, to which I say, 'Absolute nonsense.' We are in a totally different insurance market than we were in 10 or five years ago. Firstly, we know that at least in one very public way an insurer did fail. As a result of that there are professionals walking around the country, be they directors, barristers or solicitors, who carry the risk themselves. There may be access into some fund which may contribute something in the future but for current purposes they are at risk themselves in circumstances where they never ever dreamed they would be. Secondly, in respect of whole areas of endeavour—and I would say small business—there is no insurance because the cost of conducting a small business is such that once you add that into the equation it is hardly worth opening up the shop. So they self-insure, and we have heard from the Australian Institute of Company Directors just now on that very point.

Even in relation to public company directors there is of course D&O insurance available but it is expensive and it is limited. If there is the Armageddon claim, the claim will invariably go beyond the cap, so the individuals are at risk. In a professional sense, you only have to look at something like the claims that were made that were ultimately unsuccessful in the Duke Group litigation, where it was contended that in respect of the firm of Nelson Wheeler, as constituted by the Perth firm that was giving advice about a takeover, there may be a national partnership and all of the partners of that firm were at risk at levels, in terms of the claim, far in excess of any cover that may have been taken out by those individual firms across the country.

Let us talk about compulsory insurance in the professional sense. For my constituents—the solicitors—there is individual insurance that covers, as part of the right to practise, $1.5 million. You do not need a very big claim before the individual's assets are exposed. There may be top-up insurance but it is expensive, particularly for the middle ranking firms. We have the large firms such as mine taking out massive layers of insurance to cover large claims. This morning I looked at the *Financial Review*, which has published tables of large firms involved in takeover activity and the amount of the consideration of those takeovers, and they were in the billions of dollars. You immediately see that there is a risk in the context of professionals where there is at least a potential for claims far in excess of even the high level of capping of insurance taken out by large firms. In the Arthur Andersen situation, you have claims where each of those partners is at risk. There is a real issue about whether insurance, for instance, has the perfect fix.

We have overlayering the current problems associated with insurance a different governmental solution, which is the professional standards legislation which is becoming operative across the country. The scheme seeks to cap liability at what would be the upper level of the insurance cover. Even there there are problems. First, it is not operative throughout the country. We have just seen coming through the federal parliament a couple of weeks ago some federal legislation which supports that scheme and would prevent claims being brought above cap levels under trade practices legislation, corporations legislation and ASIC legislation.

But in the existing schemes we have at least a problem in relation to personal injury claims, where that is completely hived out, and we also have the difficulty of bringing them, at least in the short term, into each of the other jurisdictions. And that just covers the professions. Beyond that, you get into issues like small business and companies and you have significant problems where the current situation is that insurance just is not the fix and, even if you go to the markets in London, you have all sorts of limitations.

There may be, even in relation to fraud, innocent partner fraud cover such that it is procurable but at a very high cost, so by and large people self-insure in relation to this area. It is just not a perfect solution at all to say that insurance provides the perfect cover. What I fear is that, if this legislation, which has a doubtful justification in my submission, is not stopped by this committee's report or by the parliament in some way, shape or form and if we are not driven back to providing a solution which does not use—to quote Michael Lhuede—a 'thermonuclear device' but just uses the silver bullet, then we will see areas of endeavour such as public company directorships trimmed back. People will just not take the appointments. Heaven help us, there are enough impediments to taking office as it is without having to add a layer on top of it.

There will certainly be a disincentive for people to open up shop and conduct small businesses, and some of those small businesses are in fact solicitors. Among my constituents I have people who could only be classified as sole proprietors or small business people. They are not all high-income professionals; in fact, they are the exception rather than the rule.

CHAIR—Yes, they are.

Dr WASHER—Mr Lhuede, I had a moment of anxiety when you said that we could possibly go to a state where we did not forgive debt from the tax office. That would mean that, if I, you or anyone else were to genuinely go bankrupt for whatever reason, generally we would owe tax money as part of that. In the trade-off we could not pay so many cents in the dollar to the tax office like we would to all other creditors. If we owed a considerable amount of money, we would never get started again, basically. The Law Council would not advocate having a perpetual debt to the tax office that would not be forgiven?

Mr Dale—No, and in fact it is not part of our submission. It does not need to be part of our submission.

Dr WASHER—No, but you can understand my panic when I heard that. What I am saying is that it would not be an alternative way that you would recommend as such, would it?

Mr Lhuede—To the extent that it is a problem, once a person has gone bankrupt—and we suggest it is in the mixing pot, if you like—the practical result of it would be that the person, subsequently to becoming bankrupt, would still have the tax liability hanging over their head. The ability of the commissioner to then continue garnishment proceedings post bankruptcy et cetera would continue to exist. Equally, to the extent there were income tax returns et cetera, they would undoubtedly claim those until the debt was extinguished. Our primary submission is that there is just no case for any of this. If there is a case that the tax office is being unjustly deprived of its entitlements and rights, this has been put forward as a possible solution which would be the lesser of two evils. Rather than the broad brush of the thermonuclear device, which

is proposed in division 4A, it is more the smart bomb approach of saying: if you do have a real problem with tax, put the fear of God in people. Tell them it is never going to be released.

Mr Dale—But let the case be made out—it has not been made out.

Dr WASHER—Absolutely. At the end of the day this is on public record, so of course we could not let that be left behind and you can see why I am challenging it. It is not an option. I think we would all agree—and I mean this in the most friendly way; I am not trying to be provocative—when I say that I do not think the tax office has done its job, quite frankly. I do not think the law that we currently have has been tested adequately and failed as yet. There is an appeal, but that appeal has not been lost as yet.

Mr Lhuede—At the moment, as the case stands, the trustee has won at first instance. Yes, there is an appeal; there are those rights there. With respect to the tax office, it is a large organisation with probably the largest management responsibilities of any organisation in Australia. I cannot think of anything larger which has to collect the payments which it does—it keeps the country running in that regard. It has an onerous task. But it does have existing powers. It is using them sensibly today. We just do not see that the problem is a problem today. Yes, it was. It has been fixed.

Dr WASHER—Basically that is my perception. This is a historical problem that we are addressing with a new and potentially very dangerous law in terms of the viability of our businesses into the future, and certainly for innovation.

Mr Dale—It is absolutely critical to any understanding of bankruptcy to know that the status quo or the preferred course is clearly a release from your debts on bankruptcy. An exceptional case needs to be made out to change that principle. If you look across government policy in the last 10 to 15 years what you actually see is a lowering of the tax office's status to just a general unsecured creditor. We submit that that is appropriate, and there is nothing made out here to justify anything more than that.

Mr Lhuede—What we have put in our additional submission this morning by way of the letter of 30 June to the Attorney-General was a number of suggestions in relation to reviewing the offence provisions. The offence provisions under the Bankruptcy Act have not been touched, to my knowledge, in many years. They are almost archaic in some regards. What I raised with the Attorney when I met him at the insolvency trustee conference was that there is no provision in the act at present to prosecute a person who intentionally goes out and puts their assets out of the reach of creditors. If we recognise that as something we wish to stop, and the act certainly treats it as something which should be dealt with, then why not create the offence? But the added aspect of it is that there is an industry out there that tells people how to dispose of their assets so as to keep them out of the hands of creditors. There is no problem with people advising someone how to structure their affairs. There is a problem, I submit, when they do it when that person is insolvent. It is to deal with that problem—disposing of assets when a person is insolvent—that is the real issue.

CHAIR—I think you are making quite an important point here. You have said today that there is not a problem and that the case has not been made out to bring in such far-reaching legislation as we are looking at. On the other hand, you are saying there is a problem out there of people

who are giving advice to people who are insolvent or apparently about to go insolvent as to how to protect their assets from their creditors. We are making a distinction between making it possible for the trustee to attack any and all transactions in the event of something unfortunate happening just in the perversity of nature and the case of someone who is a serious financial trouble and wants to preserve assets.

Mr Lhuede—Exactly. No-one questions—

CHAIR—No-one questions that. To date we have all concentrated on high-worth professionals who are unincorporated being able to evade or avoid tax. That has been the focus. Add to that other creditors, because if you look at the stats the tax office is a minor creditor when you look at the rest of the creditors. So what I would like you to direct your mind to is what sorts of amendments are required to attack those people who are in fact both abusing the Family Law Act and manipulating their affairs to defraud creditors.

Mr Lhuede—The law, as it presently stands, is probably adequate. Section 121 is really a simple provision: if a person disposes of their property with the intention of defeating creditors, it is subject to a clawback.

CHAIR—Yes, but you have got to prove the intent. That is the difficult part.

Mr Lhuede—That is where the problem lies. The real problem is the question of proof. There are different aspects of that. There is a huge cost involved in obtaining that proof and, at the end of the day, that is probably the single biggest issue for a trustee: how do you fund the examinations and investigations required? If we are looking at making the job of the trustee easier, we have suggested some possible amendments to 121 in particular.

CHAIR—I am going to come to those in a minute, from your submission, but what this act is trying to do is make it easy for trustees, by deeming the property to be tainted and therefore putting the problem on the person who really is the recipient to prove that it is not tainted property.

Mr Lhuede—The real problem with the act is that it does that without tying it back to the intention to defeat creditors. What it is doing is saying that the trustee can bring that claim in isolation and, if someone wants to defend it, they have to prove that it was not for insolvency. That is the problem.

CHAIR—Yes. I just want to go to a couple of the proposed amendments in your submission—where you talk about the case of Houvardas v. Zaravinos. Would you like to tell me about that case? I do not quite understand why you then go on to say that you should insert a new subsection 9(2) to say:

"It is intended that ss. 120 and 121 cover the field in respect of the avoidance of antecedent transactions".

What acts are in competition that you want to cover the field for?

Mr Lhuede—The Property Law Act, the old Statute of Elizabeth, which was disposal of property with the intention of defeating the claims of creditors. That still exists in all property

law acts in Victoria. What happened in Houvardas's case was that a creditor brought such an application. In the meantime, the subject—the debtor—went bankrupt. The creditor continued with its claim and actually succeeded under, I think, 174 of the relevant New South Wales legislation, the Conveyancing Act—and I have not referred in our submission to the Victorian provision, but it is there. You then have a contest between the creditor, who has just set aside a transaction, and the trustee, who is supposed to get in this property under 120 for the benefit of all creditors.

CHAIR—So you have a preferred creditor by virtue of state legislation, because this does not cover the field.

Mr Lhuede—Exactly, and that was the finding of the court. It is interesting, because I have had an identical case in the past for the official trustee where that argument was not raised. I recognise the decision; I do not necessarily like it. But it is certainly one which might be the subject of an appeal—I do not think it has been appealed—and it is certainly something that, as we see it, needs fixing, because otherwise it is effectively preferring that creditor who gets in early.

CHAIR—It is, by using state law. You also say, and I am not quite sure what you are referring to in this dot point on page 29:

The perceived problem would be solved by the addition of the following paragraph (aa) before each of paragraphs 120(7)(b) and 121(9)(b): "(aa) a person who effects a transfer of property that results in another person becoming the owner of property otherwise than for market value is taken to have transferred the latter property to the other person".

I am not quite sure what you are referring to as the 'perceived problem' and why that fixes it.

Mr Lhuede—Am I able to take advice on that, Chair? I know who that suggestion came from and I am not sure what he was angling at.

CHAIR—I am not sure either.

Mr Lhuede—I can certainly take that on notice. I know the person is currently overseas, so it might take a few weeks, that is all.

CHAIR—I do not know that we have got a few weeks.

Mr Lhuede—If I can figure it out in the meantime—I have got the memo, having put this document together.

CHAIR—Then you go on to say:

Third party consideration and interaction with s. 122 - New paragraphs 120(5)(e) and 121(6)(e) should be inserted—

which would read:

"without limiting the operation of s.122, if and only if the transferee was an associated entity of the transferor at the time of the transfer and the transferee fails to prove that the transferee was at that time unaware that the transferor was, or was about to become, insolvent, past consideration".

Mr Lhuede—That is effectively deeming consideration in circumstances where there is the related entity, which means that consideration did not pass. That to an extent would seek to overcome the problems with the bona fides that I alluded to earlier.

CHAIR—That is what I was saying: is this an alternative to inserting bona fides?

Mr Lhuede—I think that was the intention in this case. I know the same person did that one as well. I understood that was the intention. My view was that you probably—

CHAIR—You know what committees create, don't you? Camels!

Mr Lhuede—Exactly.

CHAIR—If you can think about those two. The thing that is exercising my mind at the moment is how we effectively prevent abuse of the Family Law Act with regard to financial settlements and indeed maintenance agreements.

Mr Foster—I agree with Michael, in that I do not know that there is any provision in the Family Law Act anymore that would need changing to enhance the chances of avoiding abuse. Trustees can be heard, and there were some amendments made in the wake of the Jodee Rich case—

CHAIR—You think those amendments are enough, do you?

Mr Foster—Yes. They deal with financial agreements, and the trustee has the power to—and does from time to time—step in and ask for orders to be set aside, or to become a party to the proceedings. So I think it gets back to what Michael was saying too: the only impediment probably is getting the facts, and that is a question of resources as well as the practicalities of getting inside people's affairs and finding out what they have actually done. But once those facts are to hand and if the trustee or the creditors are sufficiently motivated then I think the law is available to them.

CHAIR—You agree with taking binding financial agreements out of the definition of maintenance?

Mr Foster—Yes.

CHAIR—You are happy with that?

Mr Foster—Yes. They are undeniably a way of settling property. I am sure the only reason that they ever were there in the definition is that once upon a time there were section 87 maintenance agreements and they were abolished.

CHAIR—But again I am remembering the point that you made that there would be nothing to stop parties to a divorce proceeding from going before the court and asking for a court order with regard to—

Mr Foster—Yes, but the court has that supervisory role, as judges constantly remind us, and—

CHAIR—And then a trustee could intervene?

Mr Foster—Yes, absolutely. Although people whose trade is insolvency work take some persuading about this, the reality is that in every single case in the Family Court the first step is to require a sworn statement of assets and liabilities. That has to be addressed in the course of the settlement process, or the orders would not be made. Could I make a few other comments, if it is useful?

CHAIR—Yes, please.

Mr Foster—The fact that there are two representatives of the Law Council of Australia here reflects the fact that, while we have always recognised that there are different perspectives on these problems—and the fact that there are two submissions reflects the fact that there are different perspectives, the insolvency perspective and the family law perspective—we have found that there is much more common ground than we had thought. I think there is complete common ground on the inappropriateness of the schedule 1 amendments, so I have not seen the need to address those at all.

To us, the schedule 2 material about family law and bankruptcy had its genesis well before 2001, because the Family Law Section has been in dialogue with the Attorney-General's Department since 1999 about achieving what we call 'a harmonisation' of bankruptcy and family law.

CHAIR—Really? So it has been doing that since 1999?

Mr Foster—Yes. I have here copies of some of the correspondence that has gone quietly backwards and forwards. Our aim was really to eliminate the situation whereby, say, a mother and wife of 20 years standing—having raised three children and being separated from her husband, who has just become bankrupt—could find herself unable to get anything for those 20 years other than through an equitable claim, which is an extremely uncertain path to take. We suggested it was high time for that to be regularised by an acknowledgement that the wife in that situation could make a claim at least to have acknowledgement of her contribution under section 79 of the Family Law Act. I do not think our proposition went so far as to suggest that the needs factors in section 75(2) of the Family Law Act ought to also receive an acknowledgement. We were just keen to make sure that it would be a vast improvement over the Baumgartner approach.

With the equitable claim, at least there was an acknowledgement of the Family Law Act concept of contribution. As Michael has acknowledged in this submission, there has been a shift of the law gradually, even in terms of equitable claims, to acknowledge that non-financial contribution is almost as important as financial contribution. This legislation, at schedule 2, has

probably gone a little bit further than we had expected, so it takes into account all of the considerations under the Family Law Act claim, including needs considerations. So we are not unhappy about schedule 2, but the insolvency side of the Law Council of Australia is less comfortable with it. There is a commonality in the sense that we both agree that there has been a shift in the way in which the law recognises contribution in relationships and we agree that certainty is desirable. What I think Michael is suggesting in this submission, without putting words into his mouth, is that, if we are going to go down that path, the schedule 2 path, there needs to be a broader review of this area, whereas we are saying we are happy enough with schedule 2.

CHAIR—I have a real problem with the jurisdictional question.

Mr Foster—In which respect?

CHAIR—I have a real problem with giving the jurisdiction to the Family Court, because whole classes of people are excluded from that jurisdiction. We have just enacted legislation to make sure that same-sex partners are way outside the jurisdiction.

Mr Foster—Yes, indeed. The Attorney-General's Department tell us that by April next year they expect that there will be legislation in the House of Representatives to enable the reference of powers to the states in relation to de facto property. The same-sex thing is an element of that, but we know that the Commonwealth, under this government, would not accept it.

CHAIR—One of the reasons given for having a definition of marriage under the Marriage Act was that people who did not meet that definition did not have access to the Family Law Act. That was one of the stated purposes.

Mr Foster—I acknowledge what you are saying. One thing that has been the subject of a little controversy between the two sides of the Law Council in relation to this is: which court?

CHAIR—I see the other side of the problem. If you vest the jurisdiction in the federal magistracy, then what you are doing is having to start a fresh action, because whilst you are in the Family Court—if you are entitled to be under that jurisdiction—it remains one action, because the judge has the ability to deal with that additional material, whereas if the jurisdiction rests with the Federal Court you have to begin a fresh action. If you are a person who is a male married to a female to the exclusion of all others with the intent for life, you are in the only group which has access to the jurisdiction. Everybody else has to have a separate action. But it would be a single action in the Federal Court.

Mr Foster—My personal feeling, though, is that the choice of court probably ought to be left to the courts and not necessarily be prescribed. In an era in which we have a federal magistrate's court which is expanding and has been very successful, that is a pretty easy proposition to put. That of course picks up those jurisdictions anyway. I suspect that both the Federal Court and the Family Court, faced with these sorts of matters, would probably make their own decisions as to where to send them. So there would be, for example, matters where the primary issues would all be Family Law Act type issues, and there would be a small bankruptcy aspect.

CHAIR—I am just looking at the dollar signs ticking up and ticking up.

Mr Foster—I am not suggesting both courts. I am suggesting there would be instances where the Family Court would say, 'The primary issues between the parties here are going to concern the trustee in bankruptcy, and the Family Law Act provisions will be very ancillary to the Federal Court.' In another case it might be that there are all sorts of complicated Family Law Act issues, maybe even collateral children's issues, child support and so on. I imagine the Federal Court might well say, 'This is not for us. We appreciate that there is an insolvency issue there, a bankruptcy issue. Perhaps the Family Court ought to deal with that.' But in the end, given that the federal magistrates court has a jurisdiction of $700,000 in relation to property, this issue probably will not arise, because the reality is that most bankrupts are—

CHAIR—Which state of Australia do you come from?

Mr Foster—Tasmania.

CHAIR—If you lived in Sydney you would not be making such a statement.

Mr Foster—Indeed. On the Tasmanian point, can I just say that Tasmanian lawyers are a classic example of the way this insurance thing pans out. We all dutifully paid our premiums; we even took out top-up insurance. The mandated insurer was HIH. We are told that the Commonwealth rescue package does not reach to the practitioners in Australia. We will all bear whatever liabilities arise. We are completely exposed.

CHAIR—What happened to the negotiations, which I thought had been settled, to get rid of joint and several liability and have proportionate? What happened to all those discussions? I thought that came out of the discussions on doctors.

Mr Dale—I do know that some further legislation has just been passed in the federal context, which has added something to that only just recently. But it still does not get over the potential joinder of law firms, for instance, in large transactions. Even though there may be a trimming down of their actual liability, they will still be joined and they will still be at the bargaining table in any settlement.

CHAIR—I though we got rid of the concept where you could pick who you sued.

Mr Dale—If we are not totally there, then we are certainly moving in that direction. What I am saying is that even if you do they will still be joined, particularly in large suit litigation.

Mr Farrar—The ACT government has introduced an amendment to the civil rights act which introduces proportionate liability as part of a raft of things, including professional standards legislation. I do not know if the other states are doing it.

CHAIR—Thank you. At least somebody can comment on it.

Mr Dale—It is being done. I just cannot speak off the top of my head about every jurisdiction of Australia. Some of them are in different stages of progression. Even if there were legislation across the country which dealt with that issue, it still would not prevent the joinder.

CHAIR—I accept that. To my mind we have certainly looked at some possible amendments to improve 120 and 121. One of the suggestions you will go away and deliberate upon. The cover the field provisions make sense to me; I like those. We still have a difficulty with regard to how we handle the difficult abuse of the Family Law Act and the question of jurisdiction. We have not even touched this afternoon on the question of the constitutionality of the provisions in the exposure draft and whether the proposition is that it is a proper exercise of the bankruptcy power and the incidental power or whether it might infringe the acquisition of property provisions of the Constitution. Do you agree?

Mr Dale—We certainly do. We say that there is certainly a rich debate to be had if we go down this path, which would not be had if we just had some ad hoc amendments to sections 120 and 121.

Mr Lhuede—The potential problem with these is that to be a law with respect to bankruptcy, if you are going to set aside a transaction which happened some time ago—

CHAIR—Which is not attached to the bankruptcy per se—

Mr Lhuede—It has to have occurred at a time when the person was insolvent. The parliament is simply saying that we are going to put the onus upon a third party to prove that the subject was insolvent at the time. It does not necessarily make it a law with respect to bankruptcy, because that would be akin to the parliament saying, 'We say it will be in respect of bankruptcy, therefore it is.' What happens if the person does not have the requisite knowledge. There is no onus upon the trustee to establish insolvency, and that is the weakness of it—and the real issue involved.

CHAIR—Mr Burmester seems to be of the view that it probably is a proper exercise of the bankruptcy head of power. But, as you say, it is open to a nice rich debate.

Mr Dale—Indeed. It is a debate that we will not need to have, if we do not go down this path.

Mr Lhuede—To take the argument somewhat further, you could argue that under the present section 120 there is a five-year provision. Between nought and two years you do not have to prove insolvency. However, that derives from the longstanding common law provision. It is because it was introduced law at the time of Federation or at the time of settlement that our laws have accepted that as being a legitimate exercise of power. It would be when you got beyond that—and this law will certainly go beyond that—that we would have a potential problem. It is why section 121 is a legitimate law. It ties it back—

CHAIR—It ties it to the act.

Mr Lhuede—It ties it back to the insolvency at the time.

CHAIR—I take that point.

Mr Lhuede—There was one issue raised this morning in relation to the consultation process. If you turn to page 7, 3.2, of the Law Council submission, which I prepared, I did put in a chronology of events. It was one of the documents that I handed to Mr Bergman this morning to lay down the chronology which occurred. I think that your summary of our hearings at the

commencement of proceedings was accurate, with an exception. I have been the Law Council consultative forum representative and have been involved since day one in all of this process so I have tracked it through. There are two points. Firstly, the fact that the current bill is not necessarily a result of the task force report—

CHAIR—Clearly, it is not.

Mr Lhuede—was news to me this morning.

CHAIR—Really?

Mr Lhuede—Yes. I am not aware of anything previously where the government has said, 'We are no longer going with the task force report, but here is the problem and this is the result.' So that was news for us this morning. When we attended the workshop on 4 February we were presented with a draft bill and we were informed that we could comment on this as a law which would work or would not work. We were specifically told that we were not invited to make comment on it from a policy perspective or as a good or bad law. So we were not consulted in that regard. If this is a result of something quite different from the task force report then we have not been consulted.

Mr Foster—I would add that we were not invited at all. I can only assume that it was because they recognised that the family law implications were not very attractive and that we would only complicate matters.

Mr Lhuede—The other point I would make is that, in January 2002, when the task force report was first issued, it was not made public until July. That was only after a considerable uproar by the public saying, 'Here is this report being referred to in a discussion paper but no-one is allowed to see it.' It was not issued in its totality. It was edited. It was not issued until July 2003. As far as we knew until this morning, recommendation 3 is what we now have. It said that a committee be formed 'to review the law relating to "looking through" asset ownership structures under the Bankruptcy Act ... in consultation with relevant stakeholders'. On 15 July a paper was released for consideration by the consultative forum for a meeting to be held on 29 July in which, in relation to recommendation 3, it was noted that 'the committee has commenced its review of the relevant law'. We were not and never have been consulted.

CHAIR—Who was the committee?

Mr Lhuede—The committee was the task force committee, as far as I understand.

CHAIR—I asked if they had an IDC, and they said the task force was virtually the equivalent of an IDC.

Mr MURPHY—The Attorney-General's, ITSA and the tax office.

Mr Lhuede—Yes. On 22 March 2001, the Attorney-General and the Assistant Treasurer announced the committee. It was to be an interagency task force comprising the Attorney-General's Department, ITSA, Treasury and the ATO.

Mr MURPHY—That is right. As I am sure we are near to conclusion, can I say—and this might provide a modicum of relief for all of us, notwithstanding our deadline of 10 days to report on this bill—that the submissions are now totalling 130 and are still coming in. Taking into account the fact that this 40th parliament is in its dying moments and there is no guarantee that we will be resuming here on 3 August, there is absolutely no chance of this bill getting into the parliament and getting through the Senate. So I think we should have time, because all of us have not had sufficient time to properly consider the submissions and the ramifications of the legislation. There has been pleading from a number of the witnesses from today and yesterday for more time and more consideration. I extend to you people who are experts an invitation to put before this committee anything else that you think might be relevant, because we want to get the balance right. You have just pulled together what everyone has been talking to us about at yesterday's and today's hearings, which is that a sledgehammer has been created to crack a nut.

Mr Lhuede—We recognise the realities. As I understand it, this committee disbands immediately upon the calling of an election. We were advised of this—

CHAIR—When the parliament is prorogued, we disband.

Mr Lhuede—We have been through this process and, I presume, under a new parliament there will be a new committee. My concern is, in that case, what becomes of today's proceedings?

Mr MURPHY—It is a new government.

CHAIR—It depends. If the reference is renewed then everything remains on foot.

Mr Lhuede—That was my concern. As far as I know, we now have two entities or interest groups coming out in favour of this bill—the ATO and the Inspector-General's office, which is part of the Attorney-General's office. Of your 130 other submissions, I would be interested to know who else has come out in support of the legislation.

CHAIR—Nobody.

Mr Lhuede—In that context I would welcome the committee's report as soon as possible. If it is to go back to the drawing board, we would like to know that so that people can start looking at what the real issues are.

CHAIR—You would not have to be a genius to work out that the majority of the submissions would have come from lawyers and accountants. The proposition was put earlier that most of the submissions were from people looking after their own turf and their own interests. I do not accept that. I think it is perfectly legitimate for people who have that skill and that knowledge to be making comment on what is highly technical legislation. We are looking at every aspect of the submissions that have been given to us. We did hear evidence earlier from a group that looks after—in terms put by the witness—'poor little people who go bankrupt' who thought that those people should be quarantined entirely from the operation of this sort of legislation because that would not be fair to them. It is not just people who are in the professions as such who are concerned.

Mr Dale—We should also not forget that the most common form of bankrupt is in that category—the small person who goes broke.

CHAIR—That is right. The witness gave us four case studies.

Mr Dale—This is the difficulty with ad hoc amendments to the act which create colour and motion but do not really add an enormous amount.

CHAIR—This legislation is creating the totally new concept of 'tainted property' and the act of tainting. We have established that this is not borrowed from any comparable jurisdiction. It is a brand new concept that has come out of left field.

Mr Farrar—There are those basic and significant issues of principle that you have identified. If the legislation nonetheless goes forward in that form to enact those principles into law, we still have some practical problems with the implementation provisions and some of the less important but still significant amendments to the Family Law Act—on our side—which are proposed in the legislation and which we think will make the day-to-day operation of the law quite difficult and quite different from what it is now. So, even after the basic matters of principle are determined, and the legislation stays in its current form, we would still like to say that we need to look at the detail a bit more closely.

CHAIR—We will take those comments on notice, but at the moment we are going to look at what has been referred to us.

Mr Dale—Getting back to that issue of the so-called tainted purpose, it really troubles us to have, in an almost Orwellian sense, a definition which deems things to be tainted when they are not. It is really quite troubling.

CHAIR—Yes, that is exactly right.

Mr Farrar—We talk in our submission, from a non-bankrupt spouse's perspective, of the enormous cost, not to mention the emotional turmoil, that is created by having to fight a trustee.

CHAIR—Immediately you reverse the onus of proof you put an enormous financial burden on the person who has the costs.

Mr Dale—And in reversing the onus of proof you are reaching into the family unit and creating turmoil.

CHAIR—I expressed it earlier in the day, and have done so a couple of times, by saying that the legislation seems to be attempting to quarantine creditors from risk—protect them from risk—but the risk is in fact being transferred onto the family of the debtor. That then becomes a competing public policy question.

Mr Farrar—The point I wanted to make earlier was: without any guidance in the legislation, how will the court deal with the competing interests of the non-bankrupt spouses versus the creditors.

CHAIR—I accept that. If the Family Court were to be given the jurisdiction, I think it would have an enormous problem.

Mr Farrar—Whether it is the Federal Court or the Federal Magistrates Court, they will still have to deal with those principles. Under the Family Law Act at the moment, the Family Court usually takes the property and liabilities as it finds them, and creditors normally rank in priority and the parties divide what is left over—the net assets. Sometimes the court will ignore debts if it is found that they should be visited on the head of one party because of culpable behaviour or something like that, or because they do not really think it is a true debt—like a family debt that has never been called in, or something like that. These changes seem to elevate all creditors into a superior position.

CHAIR—Superior to the family?

Mr Farrar—Yes.

CHAIR—Exactly. That is what I mean. The risk is transferred from this group of people to that group of people. It has not gone away; it has just been transferred.

Mr Foster—There has been a lot of criticism of the drafting of the factors to be taken into account by the court under section 139AFA. When I read them, I thought it was hard for the draftsperson to work through what the implications of these should be. In the end, I think they have all just been thrown in and that even the draftsperson probably could not say what it was intended would be the consequence of taking into account 'available for use'—not 'used' but just available for use.

CHAIR—There are many expressions there which have no meaning.

Mr Lhuede—I can give some examples which would easily avoid the provisions in the current drafting. You can defeat the whole section 120 operation and this simply because of terms like 'available for use'. You can quarantine the money in the non-bankrupt spouse's bank account, having cashed everything up, not ever make it available, go bankrupt and let the time run out. We cannot touch it, because it is never available. I cannot see a court overturning it.

CHAIR—The other thing that was interesting in the ITSA evidence was that a second transfer would defeat the whole purpose of the legislation.

Mr Lhuede—There are two obvious answers to that. The example you gave, I think, is that you give it to, say, the wife and then to the child. That would be caught under section 139AM in the new provisions, with two or three people getting together to effect an outcome. If you follow it through—

CHAIR—That is if they got together.

Mr Lhuede—If they got together. But it is caught under section 120 as it stands today. Section 120(6) says successors in title, other than for valuable consideration, are still subject to a clawback. So in the law today you could just bring a 120 claim.

Mr Foster—The other way to circumvent the tainted property concept is simply to have a Family Law Act settlement. There is nothing in the law that says you have to be separated, so you could do it. There is some argument about this; some judges take the view that it is—

CHAIR—You mean physically separated, because it is quite clear—

Mr Foster—Yes.

CHAIR—in the Family Law Act that two people can in fact commence the 12-month separation period whilst living in the same house.

Mr Foster—No, I mean that you do not have to be even intending to ever separate; you could actually be in an intact and happy marriage.

CHAIR—Perhaps we ought to fix that up.

Mr Foster—I do not know that it has been a problem. It is something that we lawyers talk about from time to time, but it is very rare that you see any instances where people would ever use it.

CHAIR—I suppose it acts a bit like a pre-nup agreement, does it?

Mr Foster—Yes.

CHAIR—Could it?

Mr Foster—But even if the correct view was that you had to have a bona fide separation, reconciliation is a virtuous act so I do not see how anybody could criticise anybody who subsequently reconciled, having had a proper Family Law Act settlement—and heaven knows, if I were a wife trying to work out how to keep the roof over my head and my children's head, I would much sooner negotiate with my loving husband than with a ravenous trustee.

CHAIR—There is the dilemma: you might be negotiating with a ravenous, hateful husband and the trustee might look quite benign!

Mr Foster—That is the thing. You made the point earlier—and I think it is so true—that there is a category of marriages which end in such acrimony that there is not much that one person would not do to poison the well of the other party.

CHAIR—Absolutely.

Mr Foster—And there is nothing to lose; it is just a question of making a couple of phone calls and writing a couple of letters and starting the hares running.

CHAIR—That is exactly right.

Mr Lhuede—There is precedence for people going bankrupt with the sole intention of defeating their former spouse's legitimate claims. There is power in the court, if it is a sequestration order—is it a debtor's petition to set it aside?

Mr Foster—Yes.

Mr Lhuede—The court can set them aside in certain instances, but it is somewhat restricted because of an abuse of process conclusion.

CHAIR—Hopefully, the official receiver might use his new power and refuse to accept the—

Mr Lhuede—I do not think there is scope to do that in that scenario. If a person is genuinely insolvent, there is not a lot the official receiver can do. It is where the person has disposed of property to the wife and then goes bankrupt to make it all available for clawback that that happens, and it is not pretty.

Mr Farrar—It is a fairly common phenomenon that family gifts suddenly become debts, or allegedly debts, when parties separate, and it is not unforeseeable that somebody could allege that they owed their parents money and go bankrupt on the strength of that. That debt is then proved in the bankruptcy, and of course the bankrupt says it is a debt—no-one is going to deny it, as far as the creditor and the debtor are concerned. Suddenly the trustee is into the matrimonial property which, had it been a normal property dispute, the Family Court would have adjudged whether it was truly a debt or not.

CHAIR—It is pretty ugly, isn't it?

Mr Foster—In the last 20 years I would have had dozens—and I am sure Denis would have too—of mainly men who have said, 'I'll go bankrupt; that'll fix her.' Then of course you give the advice about the implications of that, and they settle down a bit. It is high on the list.

CHAIR—If they are vicious enough and unbalanced enough, they will do it.

Mr Foster—Yes, it is one of the first possibilities that enters people's minds.

CHAIR—Thank you very much for your testimony today.

Mr Lhuede—If you require any further assistance, the position of the Law Council is always: let us know and we will do what we can to assist.

CHAIR—Thank you very much. I declare this public meeting closed.

Resolved (on motion by **Mr Murphy**):

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 4.22 p.m.