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Bankruptcy

Submission No: *30*

15 June 2004

The Secretary
House of Representatives Standing Committee on Legal and Constitutional Affairs
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

BANKRUPTCY LEGISLATION AMENDMENT (ANTI-AVOIDANCE AND OTHER MEASURES) BILL 2004

I would like to make a submission to the committee on the amendments proposed to Division 4A of Part VI of the Bankruptcy Act 1966 (the Act) by the Bankruptcy Legislation Amendment (Anti-avoidance and other measures) Bill 2004 (the Bill).

Summary

I agree with the proposition that bankruptcy should not be a mechanism by which individuals are able to escape their obligation to meet their taxation obligations when they clearly have the capacity to pay these debts. However, the proposed changes represent a fundamental shift in the law which has a significant impact on other individuals operating in a bone-fide manner in what might be colloquially referred to as "at risk" professions.

It is my submission the proposed amendments should be re-visited to adopt a system which gives trustees in bankruptcy and the appropriate authorities the necessary powers to target those who abuse the system by conscientiously failing to pay their debts and using bankruptcy as a "safety net", but at the same time, not put at risk the assets a person has worked diligently to accumulate throughout their career because of one honest mistake or negligence claim.

Detail

The Bill has been developed following the "Joint Taskforce Report on the use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax" (the Taskforce Report). Having read the Taskforce Report it seems clear the intention was to target high earning fee-for-service professionals who use bankruptcy to avoid paying tax and other debts. That is, the taskforce was targeting those people who did this on a systemic basis.

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Contrast the stereotype referred to in the Taskforce Report with “Joe Lawyer” whose circumstances are summarised below?

- (a) Joe has worked his entire career (30 years) as a lawyer in private practice and established a small law firm with a team of 3 lawyers.
- (b) When Joe established his practice he took advice and established a traditional partnership/services trust arrangement which allowed him to generate income in a tax effective manner but he always earned a significant profit via the partnership and therefore paid tax on a significant portions of his income at personal tax rates. The balance was paid to a corporate beneficiary of his services trust.
- (c) Joe’s home was owned in his wife’s name and after 30 years in practice he had finally paid off the mortgage.
- (d) Unfortunately one of Joe’s lawyers made an error in drafting a document for one of the firm’s clients. While the error was a small one, the potential damage to Joe’s client was potentially \$3 million.
- (e) Joe is insured through the law society and carries the required \$1.25 million insurance but no “top-up” cover.
- (f) Joe is sued and is ordered to pay \$2 million in damages, \$1.25 million of which is paid by his insurer. Joe is required to pay the balance \$750,000.
- (g) Joe’s practice and other assets are valued at \$400,000. He has no other assets and declares himself bankrupt.

Under the proposed changes Joe’s house and any assets owned by his family trust/corporate beneficiary would be potentially accessible to the trustee in bankruptcy even though Joe had made every effort to pay his taxes and debts as they fell due. Joe has not systemically gone about defrauding the tax office or any of his creditors. One of his staff had made an honest mistake.

It seems unjust for an individual to potentially lose all they had accumulated in their career as a result of an honest mistake.

The Attorney General has said that the solution to Joe’s problem is to take out professional indemnity insurance. With respect, this is a short-sighted comment. In Queensland the Queensland Law Society (QLS) insurance scheme offers standard cover of up to \$1.5 million. Our firm for example, works on transactions involving tens of millions of dollars. For our firm to carry insurance at a level that would provide us “100% cover” we would need to be insured for upwards of \$50 million. It is simply not economically viable for a small law firm to pay premiums on that level of cover.

Under the Bill, even if we were underinsured for, say \$2 million, it could lead to the financial ruin of our business because once the insurance was exhausted the partner's personal assets would be at risk. Personal assets they had worked hard for during their careers would be lost, not because they systemically abused the system and avoided paying their tax, but because of a single honest mistake.

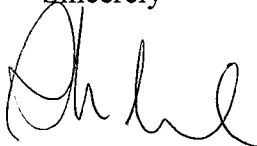
Contrast this with the barristers who systemically avoided their obligations to the ATO. These people deserve to be punished, but it is my submission the solution is not to change the law in a way which will clearly discourage small business and sole traders. If the Bill is passed in its current form, then I, and many others I am sure, will have to seriously ask them selves the question whether continuing to do business is worth risking all they have worked for in the previous 10 years. In circumstances where I have a wife and young family to consider, on balance, it would be a better risk for me to close my business and take a position as an employee. As an employer of 25 people I would have thought the government would be concerned at this prospect.

If the government's goal is to stop people abusing the system in the way some barristers and other professionals have, then in my submission the solution is to close that option to those people via subtle law changes rather than try to "crack a peanut with a sledgehammer".

What the Bill proposes will fundamentally change the way in which Australia does business. Under the Bill, the risk/reward decision of a new business venture has, all of a sudden, been swung in favour of "risk". This will no doubt mean fewer people will be prepared to take entrepreneurial decisions. This means people will not start that small business, directors will not accept the invitation to take a seat on the board and fewer people will choose professions like medicine as a career because, in a society which is becoming increasingly litigious, it simply isn't worth it.

In a country where small business is one of the largest employers, this is a serious concern.

Sincerely



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Partner

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