1 July 2004

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

Dear Secretary

Submission to the Standing Committee on Legal and Constitutional Affairs – Inquiry into the *Bankruptcy Legislation Amendments (Anti-Avoidance and Other Measures) Bill 2004*

The National Institute of Accountants (NIA) appreciates the opportunity to submit its comments on the *Bankruptcy Legislation Amendments (Anti-Avoidance and Other Measures) Bill 2004* (the Bill).

The NIA has some concerns about the Bill. While the NIA supports the original intentions behind the Bill, to prevent the abuse of the bankruptcy laws by certain high-wealth individuals, the NIA is concerned that the Bill as proposed will have unintended consequences on the legitimate arrangements of many professionals in Australia.

The main concerns that the NIA has with the Bill are:

- The reversal of burden of proof creates an unfair burden on *bone-fide* third party recipients;
- No requirement on trustee in bankruptcy to justify claims property and income is "tainted";
- Retrospectivity goes against notions of fairness and equity;
- Bankruptcy law in Australia will become ineffective for professionals; and
- Measures unfairly impact on those not the target of the legislative changes.

There are tens of thousands of professionals who have engaged in quite legitimate arrangements to protect themselves from the potentially ruinous outcome of unfavourable court action. With the introduction of "opt-out" provisions in the Professional Standards legislation, meaning large clients can in effect force their professional advisers to "opt-out" of the capped liability scheme, it is more important than ever that professional have access to legitimate asset protection measures.

The NIA believes the original intention of the Bill must be maintained, however, the measures designed to achieve this need to be more targeted. The NIA would appreciate the opportunity to appear before the Committee to further discuss the concerns of the NIA's 12,500 members.

Yours sincerely

Reece Agland
Technical Counsel

Bankruptcy Legislation Amendments (Anti-avoidance and other measures) Bill 2004

The National Institute of Accountants (NIA) wishes to raise particular concerns the NIA has in relation to the *Bankruptcy Legislation Amendments (Anti-avoidance and other measures) Bill 2004*(the Bill). The NIA is concerned that the legislation as set out in the Bill is excessive, counter-intuitive to good law making and may impact heavily on persons other than those the measures are aimed at. Given these concerns the NIA would request that the Government withdraw the Bill and enter into discussions with stakeholders to find alternative means to address the perceived problems the measures are designed to address.

The main concerns with the proposed legislation are:

- The reversal of burden of proof creates an unfair burden on *bone-fide* third party recipients;
- No requirement on trustee in bankruptcy to justify claims property and income is "tainted"; this creates an unfair presumption in favour of trustee in bankruptcy;
- Retrospectivity goes against notions of fairness and equity;
- Bankruptcy law in Australia will become ineffective, undermining the whole system; and
- Measures unfairly impact on those not the target of the legislative changes.

Rationale for the changes

The initial reasons for the proposed changes arose out the Joint Taskforce on "The Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax", which identified the ongoing problem of a number of high wealth individuals using bankruptcy legislation to avoid their taxation dues. The NIA supports efforts by Government to prevent the misuse of the bankruptcy laws to avoid tax and other liabilities.

The NIA initially looked forward to the Government's proposals to address such misuse as the misuse of the bankruptcy laws creates a perception of one set of rules for most people and a different set of rules for those in positions of privilege, as those who can manipulate the laws and their personal positions can avoid their liabilities. However, upon reading the Bill the NIA was immediately concerned with the breadth of the legislation and the means adopted to address its stated purpose.

The NIA does not believe that the measures set out in the legislation are necessary to deal with problem that is the rationale for the changes. Furthermore the scope of the Bill is much greater than merely addressing the issue of avoiding tax liabilities. It is an attack on bankruptcy itself, not just the abuse of it. The Government seems to have forgotten the rationale for bankruptcy laws in the first place and placed unwarranted power in the hands of trustees in bankruptcy. While pictures of some well known bankrupts seemingly living it up naturally create anger, such anger should not be used to attack all bankrupts.

Reversal of burden of proof and presumption in favour of trustee in bankruptcy

The rationale for reversing the burden of proof is that it is often hard, if not impossible for the trustee in bankruptcy to prove that an asset should still be regarded as the property of the bankrupt, meaning that "crafty" bankrupts can still access their assets while nominally in the hands of others. While there is understandable sympathy for the trustee, this difficulty does not override concerns for natural justice that arise from reversing this burden. This is more so when the person who is directly affected is neither the bankrupt nor the trustee but a third party who has been vested with the property.

The burden of proof is nearly always placed on the person making an allegation, unless there are extremely good policy reasons otherwise. The reason is simple, if you allege something then you should have the facts to back it up. Furthermore, it is often hard to disprove something that does not exist or did not happen. If the police allege that a person has in their possession something that they should not have (effectively what a trustee must prove), it is not fair to then turn the burden of proof back on the other person and demand that they show why it is in their possession for a valid reason. The police must prove their case, and the same should be expected of a trustee.

There are no valid policy reasons that are unique to trustees in bankruptcy that demand this reversal of the burden of proof. Yes, it may be difficult to prove a tainted purpose, but this is no different than other areas of the law, and is less difficult than a third party trying to disprove the allegation. The burden of proof should remain with the party that is alleging the tainted purpose.

An example shows clearly the problem with this.

A is the spouse of B. B is the principle income earner and A largely stays home to look after the family and run the household B purchases a car and transfers this to the name of A in order for A to fulfil their family duties. B occasionally uses the car to pick up the children or for long vacation trips they share the use. B then becomes bankrupt. According to the new rules, all the trustee needs to do is say II think the transfer of vehicle to A's name was done for a "tainted" purpose therefore hand it over". The new laws mean this will happen unless A can prove the transfer of the vehicle was not for a tainted purpose A has to hand over their vehicle. The facts A relies on would be the same whether or not B had a tainted purpose. How can A prove that it was merely to help fulfil A's home duties and part compensation for not being employed rather than some scheme by B to shelter assets from bankruptcy? How does A disprove something that was in the mind of B? The facts are likely to be inconclusive, which is not enough to rebut the presumption. (this is a simplified example but shows the difficulty of a person rebutting a presumption they are not a party to)

Furthermore, reversing of the burden of proof is likely to encourage some trustees in bankruptcy being less vigorous in tracing the real owner of an asset. All they have to do is make the allegation. A trustee is likely to simply allege as many assets as possible have a tainted purpose. It will then be for others to do the trustee's work. This is clearly not fair and abuse of process by the trustee, but is a possible outcome if these changes are legislated.

This will be exacerbated in situations where the third party does not have the resources to rebut the presumption. If the measures were strictly limited to the high wealth individuals and their immediate families this may be of less concern. However, the measures set out in this Bill will apply to all bankruptcy cases, most bankrupts are not "high-wealth individuals". These people will not be able to fight trustees in Court every time there is an allegation that an asset is tainted. This may lead to the situation where third parties are being deprived of their legitimate assets by trustees who's primary duty is to recover money for the creditors merely because they are not as well funded as the trustee. This should not be the intention nor the outcome of the Bill, but if passed in its current form, is a possible outcome.

The NIA does not believe that there is sufficient justification to warrant the reversing of the traditional burden of proof. Moreover, the NIA can see how the proposals could be used unfairly to the disadvantage of *bone-fide* third parties. It creates a perception that all assets transferred by a bankrupt, up to ten years prior, has been done for a tainted purpose without further proof and taints all who receive such property with complicity regardless of either the existence of such a tainted purpose or even if it does exist by the bankrupt, regardless of any knowledge of the third party of this tainted purpose.

The presumption is also not needed to achieve the stated goals of the Bill. It ignores the fact that trustees already have access to extensive investigatory powers (more so than the average person). They have the power to access the books of associated entities, they can examine the books of persons associated with the bankrupt, and they can examine persons under Oath. They are not so powerless as to need a presumption in their favour. They are specialised people with experience, skills and powers under the Act. If they can not prove their case, this may simply be because there is no link there. It is unfair to place the burden on people who in the vast majority of bankruptcy situations will not be "high-wealth individuals", not have ready access to lawyers and other advisers

Retrospectivity

The Bill is intended to apply not just from the date of proclamation of the Act, but is intended to cover the transfer of assets as far back as ten years prior to bankruptcy. It is generally accepted as good policy that new laws should not be retrospective, especially where they cover acts done in good faith with full knowledge of the law at the time the act was done. The reason is simple. A person should not be penalised for doing something that was lawful at the time they did it but becomes unlawful at a date in the future. While it is clear that in Australia the Parliament can make retrospective legislation (eg *R v Kidman (1915) 20 CLLR 425*) it is generally accepted principle that laws should not be retrospective unless there is a clear intention that they be and that there are clear policy reasons for applying it retrospectively.

The rationale given is that if it did not apply retrospectively then the law would be hard to implement as many of the people the changes are aimed at have already transferred property. This may be so but many other people have already transferred property for valid legal reasons to protect their assets that do not relate to the stated purpose of the Bill. These people will also be caught, and when combined with the presumption that any transfer of an asset by a bankrupt is for a tainted purpose, will mean that without having done anything wrong and acting within the ambit of the law and prudent business principles these people are already guilty of breaching the Act.

Further complicating matters is that it is likely that any documentary evidence relating to such transfers of property and income will no longer be in existence. Most people do not keep all their documents for ten years, especially where those documents relate to actions that were legal at the time they were entered into. This will make it even harder for bankrupts and third parties trying to rebut the presumption against them.

There are potentially some very worrisome outcomes if this legislation is passed. Any person in Australia who has in the past ten years transferred an asset to another is already guilty of a breaching the Bill if they ever go into bankruptcy, unless they can prove that they did not at the time intend to breach a law that was not in existence at the time they made the transfer. Furthermore, any person who has received a transfer of property or income from another has done so for a tainted purpose that did not exist at the time they received the property or income unless they can prove that they were not aware that it was done for a tainted purpose that was not unlawful at the time it was done. A truly extraordinary piece of legislation.

This outcome does not make sense. It fails any test of reasonableness and fairness.

In the Prime Ministers own words against retrospective legislation:

> *"It is fair and reasonable and entirely defensible, indeed well argued, proposition that people who enter into an arrangement for part of their career on a certain basis are entitled to enjoy the entitlements of that arrangements as they enter into them"* (sic)

Unwinding bankruptcy law in Australia

For many small business people incorporation is not an option (in fact in some professions it is illegal), which means that they face great personal misfortune if their business does not succeed. It has been best practice that one of the few options available for small business people is to transfer some of their assets into others hands as a means to protect those assets. This is especially so when those assets are joint assets such as houses and cars. Under the proposed amendments these small business people are deemed to have acted for "tainted" purposes and will no longer have the protection that was previously legally available to them. Not only that but the legitimate rights of those to whom the assets have been transferred are now lost in favour of the trustee in bankruptcy. The rights of the trustee in bankruptcy should not override the *bone-fide* rights of other people.

The combination of retrospectivity and the presumption in favour of the trustee in bankruptcy means that Australian bankruptcy laws for small business and individuals no longer function as they were intended. Bankruptcy is provided as a means to ensure people can re-organise their personal affairs while protecting the rights of creditors. Bankruptcy also currently recognises the rights of parties other than the bankrupt and creditors and protects those rights unless it can be shown that there has been fraud or other serious malfeasance. The Bill will in effect do away with this system and in its place insert a paramount position for creditors over the rights of all others, with a presumption that actions that were once legal and best practice are now tainted.

This is a long way from the proposed system that was designed to deal with a small number of high income owners who have deliberately structured their affairs in such a

way as to avoid their legal obligations. These people may be caught up in the effect of the law (though one fears that they have the means to try and avoid these changes) but a whole class of other peoples rights will also be affected. If the Government's intention is to fundamentally alter the bankruptcy system, then the Government needs to state that this is the intention. The changes clearly are not aimed at just the small group of people the Government has claimed were the targets. Many people who have agreed with the initial intentions of the Government will be shocked to find that real intention, or at least the effect of the changes, are much broader.

The Bill seems to suggest that the Government is of the opinion that all actions by people, especially small business people who can not utilise asset protection afforded by corporations law, to protect their assets have been done for some underhanded purpose. It is not illegal (at least at the moment), underhanded or improper for a person to protect their assets.

Alternate approaches to achieve objectives

One of the rationales for the Bill is the belief that the ATO does not have the resources or the expertise to run cases against the high-wealth individuals. If this is the case then it is the role of the Government to ensure that those skills and resources are made available to the ATO. Changing the Bankruptcy laws in favour of trustee's in bankruptcy and diminishing the rights of people does nothing to improve the ability of the ATO to run cases against "high-wealth individuals".

If the ATO lack these abilities it should be funded to either acquire these abilities in-house or to outsource its debt collection to the many experts that already exist. It is not a weakness of the Act, rather a weakness in finding cost effective means to do the job.

The ATO can not claim to have a lack of information about many of the assets owned by the bankrupt and their associates. The ATO already has access to large database of information on ownership, transfer and disposal of assets. It can look up individual, partnership and other tax details collected by the ATO itself. The ATO has very strong powers to demand information not only from individuals but also their advisers and associated entities. The ATO is not information poor. While the presumptions in favour of the trustee in bankruptcy will make things easier for the ATO, it can not be said that the ATO is totally powerless in collecting the information it needs.

If there are problems with members of specific professions, then the ATO should do more to liaise with the professional bodies of the people in question. These professional bodies will have their own investigative powers and the right to take action against there own members. If their members are abusing the law, then they should be informed so that appropriate action can be taken. Members of the three professional accounting bodies are not permitted to remain as a member while they are bankrupt, the threat of bankruptcy is therefore a serious threat to their income producing abilities. In NSW the *Legal Profession Act (NSW) 1987* allows for a solicitor or barrister who has engaged in tax avoidance activity can have their practising certificate suspended or even cancelled. The ATO should be prepared to work more closely with the professions in question to try and find ways to avoid the abuse of the system. The accounting profession is keen to ensure that there members activities are above reproach, because, if they are not, the reputation of the profession suffers.

There are means to achieve the desired ends without impacting on the rights of all bankrupts and their associates. Such measures will have a greater effect in achieving those goals than the proposals set out in the Bill.

Conclusion

The NIA can not stress strongly enough its concerns about the impact the Bill will have on persons other than those intended to be the target. The Bill creates a presumption that any disposal by a bankrupt in the prior ten years was done for a "tainted" purpose without the need to substantiate that claim. The Bill casts in doubt the whole bankruptcy process in Australia and favours the rights of creditors over the legitimate rights of other persons.

The NIA does not believe that the case has been proven for the need to reverse the burden of proof. While high-wealth individuals may have access to the recources necessary to understand this Bill, the vast majority of bankrupts do not. Trustees in bankruptcy already have extensive investigatory powers and are trained experts in their field. Reversing the burden of proof in all bankruptcy matters creates an unfair burden on bankrupts and more importantly third parties. It will be almost impossible for these people to rebut the presumption regardless of whether there is a tainted purpose or not. Bone fide third parties could be stripped of their rightful assets merely because they could not afford a lawyer to rebut the presumption in court. There is no clear case for and many reasons against reversing the burden of proof.

The retrospectivity of the Bill, combined with the reversal of the burden of proof means that the Bill is in effect saying that a third party who has received an asset from a bankrupt at a time the person was not a bankrupt (up to ten years), has received that asset for a tainted purpose unless they can show that at the time of the transfer it was not done for a tainted purpose. This is despite the fact at the time there was no law saying it could potentially be tainted. This creates an unacceptable burden.

What compounds these twin failings of the Bill is the fact that neither of the proposed measures is necessary to address the problem that is stated as the justification for the Bill. If the ATO lacks specific powers, skills or resources in relation to high-wealth bankrupts, then the Government should be ensuring these specific deficiencies are addressed. If there are particular professions that are of concern, then work with the professional bodies regulating those persons to address these concerns. If the Act is to apply only to high-wealth individuals, then make the law apply only to them.

The Bill as it currently exists creates an unbalanced bankruptcy regime that taints all attempts by small business people to protect their assets as unlawful and creates a presumption in favour of creditors over the rights of *bone-fide* third parties. The bill should be withdrawn and consultation entered into to address directly the perceived problem with certain high-wealth individuals.