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Submission No:123.....

Wilson, Frances (REPS)

From: Geoff White [gwhite@acon.com.au]
Sent: Tuesday, 6 July 2004 9:56 AM
To: Committee, LACA (REPS)
Cc: Grant Fietelberg; Bill White; Emanuel Callegeros; Geoff White; John Tsolakis; Michael D'Ambrosio; Murray Richardson; Robert Rajah; Robert Smith; Robin Fraser; Ron Targett; Simon Horry; Stephen Cassrels; Ted Conrick; Terry Duveen; Peter Polgar
Subject: Fw: Bankruptcy legislation- This is Important .
Importance: High

Attention Gillian Gould

Re Exposure Draft *Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004*

I support Robin Speed's article on the above Exposure Draft. In the Drafts present format, who would want to be in business to let some voracious Trustee in Bankruptcy take away your life's assets. There is no way that this Exposure Draft should be submitted in its present format.

Geoffrey A White

Chartered Accountant

[1090] Assets in the names of wives and associates

by Robin Speed, Speed and Stracey Lawyers

The Exposure Draft *Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004* seeks to make available to a bankrupt's creditors all assets owned by any family member or associate which the bankrupt transferred or provided any financial assistance. The Draft Bill was released on 14 May 2004, and the Bill and its draft Explanatory Memorandum can be accessed at <http://www.ag.gov.au/www/agdHome.nsf/HeadingPagesDisplay/Publications?OpenDocument>

Where creditors establish that the bankrupt obtained a benefit from the asset (no matter how slight eg occasional use of the asset) at any time prior to bankruptcy, the owner of the asset has the onus to prove that the bankrupt's main purpose in transferring the asset or providing the financial assistance was not to defeat creditors.

Example

The unprecedented nature of the Bill is best illustrated by an example.

John worked as a manager for Qantas and was made redundant at 50 years of age. He received a redundancy payment of \$300,000 and immediately went with his wife, Joan, on an overseas trip.

On returning, he tried for 6 months to find another job, but without success. Ultimately, in frustration, he decided to go into business for himself and opened a coffee shop.

In the following year, his daughter Sally asked him for help in buying a unit for her and her child to live in.

John discussed the matter with Joan and they decided to give Sally \$50,000 for this purpose.

The daughter paid \$150,000 for the unit and borrowed the remaining \$100,000 from the bank.

For the next 10 years John, with the help of Joan ran the shop.

John then became ill with Alzheimer's disease. As the illness progressed, he increasingly neglected the shop. The shop was close to his daughter's unit and he frequently stayed there, to save the long drive to his own home.

Ultimately, John was forced to close the shop - owing his creditors \$250,000 (largely unpaid rent). John used all his resources to keep the business going and his only remaining asset was his half share in the family home - worth \$175,000.

The creditors who were owed the \$250,000 forced a sale of John and Joan's home so they could receive John's half share - this left \$75,000 still owing.

If the draft Bill becomes law, the creditors will be entitled to make John bankrupt and apply to the Court for Sally to pay them the greater of \$50,000 or 1/4 of the present value of her unit.

The wide scope of the draft Bill

The Example above illustrates that the draft Bill is not limited to professionals - whether high income or not. It is important to note that:

- *The draft Bill applies to anyone - including small business, retirees, employees, company directors, financial planners, tradesmen, property owners (occupiers liability), the sick and the elderly.*
- *The draft Bill is not limited to income tax liabilities - it applies to ANY liability.*
- *The Bill is not limited to where bankruptcy is used by the bankrupt to avoid paying tax or any other liability. It applies where creditors force the person into bankruptcy.*
- *With the statutory and judicial attack on limited liability companies, the draft Bill also applies to liabilities of a company passed on to directors.*

What defences are available?

Sally would be the defendant in the proceedings brought by the creditors. As her father frequently stayed at her unit, he would be treated under the draft Bill as having benefited from the gift.

Sally's sole defence would be to try and prove that John's main purpose in giving her the \$50,000 was not to defeat, delay or impede his creditors. Sally has the onus of proof. Her father is presumed guilty.

Unfortunately, by the time the matter is to be heard by the Court, John's illness makes it difficult for him to remember the gift made over 10 years previously. John's doctor advises against him going into the witness box and being subject to cross examination.

Sally has little practical choice but to try and do a deal with the creditors outside the Court. The creditors are seeking the greater of \$50,000 or 1/4 of the present market value of the unit - plus their legal costs. Sally is forced to pay the \$50,000. She does not have the money and has to borrow from the bank. She also has to pay her own legal costs of \$7,000.

Is the bankrupt presumed guilty unless innocence is proven?

Yes, under the draft Bill, the bankrupt is presumed guilty unless innocence is proved. This is not only objectionable in our democratic system, but in practice, innocence may often be difficult to prove. What Sally in the above example is seeking to prove - without the benefit of her father's evidence - is her father's subjective purpose many years ago.

Does it make any difference that the bankrupt took all reasonable and practical steps to make sure all creditors were paid?

No, it makes no difference. The creditors are still entitled to make the person bankrupt and bring the application. In the Example, it would not matter that John did everything he could to make the coffee shop a financial success. It would also not matter that John used all of the family savings to this end, and that he and his wife were left with nothing. Nor would it make any difference that the landlord of the shop was able to release it to another tenant immediately at a much higher rent.

Does it make any difference that the creditors provided credit with reference only to the assets in John's name?

No, it makes no difference that in providing credit, the creditors did not take in account the money given to Sally.

Does it make any difference that the bankrupt was solvent at the time the gift was made?

No, it makes no difference that John in the Example was solvent at the time the gift was made and remained so for over 10 years thereafter.

Will the draft Bill have retrospective effect?

Yes, the draft Bill will have retrospective effect. It would apply, for example, to anything done by a bankrupt in 1950, 1960, 1970 and onwards. Accordingly, if John in the Example was made bankrupt in 2005 and the draft Bill were law, the Bill would apply to a gift made to Sally 20 or 30 or more years earlier.

This means that John and Sally would have lost the opportunity to document John's purpose at the time of the gift. This is particularly significant when Sally has retrospectively the onus of proof imposed on her.

If a bankrupt's innocence cannot be proved, why is there a concern - after all, the Court has a discretion what to do?

The draft Bill is deliberately drawn widely with the intention that there will be many situations where it would be wrong for the creditors to get all or any part of the assets in dispute. To deal with this, the draft Bill leaves the matter entirely in the hands of the Court. This creates uncertainty, the risk of the unknown and high legal costs in proving innocence. It would hardly be surprising if many people simply gave up and tried to do the best deal they could with the creditors outside the Court.

While Sally in the Example might bitterly resent her father being treated as guilty, she would have little practical alternative. Faced with creditors with deeper pockets than hers and with relatively little to lose - the contest is hardly equal.

What happens if the bankrupt may have had a mixed purpose in making the gift?

In the Example, what happens if John's wife Joan, after having been told about John's plan to open a coffee shop, begins to worry that something might go wrong, particularly as John had no business experience. A short time later, John gave her his half interest in the family home as a surprise

wedding anniversary present.

Ten years later, when he is made bankrupt, the creditors who are owed the \$250,000 bring a court application to obtain the half interest in the matrimonial home that John gave to Joan.

How can Joan in the above circumstances prove that John's main purpose was not to defeat or delay future possible creditors when it was her concerns about creditors which preceded the transfer? But John may only have been placating his wife - without any intention to defeat his creditors. How can Joan prove this now?

It's not too late

The Bill is an Exposure Draft (ie it has *not* been introduced into Parliament) and it is not too late to have it amended to deal with the problem by having a special provision in the Tax Act for tax debts - not a general amendment to the Bankruptcy Act.

We have lodged a submission to this effect with the House of Representatives Standing Committee on Legal and Constitutional Affairs which is considering the Bill. The Committee is scheduled to report by 16 July 2004. However, unless there is widespread support for such an amendment, the Bill will be passed.

Submissions on the Bill will be available to read at <http://www.aph.gov.au/house/committee/laca/bankruptcy> As many people as possible should send a short email to Gillian Gould at laca.reps@aph.gov.au supporting the submission they favour. This should be done no later than 9 July 2004.