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BY:

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

8 July 2004

Dear Sir/Madam

PROPOSED NEW BANKRUPTCY LAW PROVISIONS

We write to you to express our concern as to the potential implications of the proposed Bankruptcy Laws that are outlined within the exposure draft of the *Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004*.

Whilst we do not disagree with the intentions and merits that we understand that this Bill is intended to provide, we believe that, in its present form, this legislation has far too many pitfalls and consequences that could affect far more people than intended.

As members of the accounting profession, we are only too fully aware that some Australian taxpayers have, over the last decade, showed a disregard for the requirements of our existing taxation and bankruptcy legislation.

Such action, by a minority of professional taxpayers, has resulted in a loss of revenue to the government in the form of unrecoverable tax and also financial distress and loss to some creditors.

However, upon reflection, such loss has largely resulted from the actions of a small, sophisticated group of taxpayers that were, in many cases, unregulated and allowed to achieve what they did. In addition to this, it would also appear that the Australian Taxation Office might not have done enough to anticipate such action.

General Provisions

The proposed law is intended to expand the powers of trustees to recover property from a bankrupt in the following circumstances –

- Where a third party acquired property from the bankrupt using funds or property provided by the bankrupt, and
- The bankrupt's purpose in transferring funds or property was to ensure that they were not available to pay creditors and, finally,
- The bankrupt continued, subsequent to the transfer, to derive some benefit from the transferred property.

In addition to the above, the legislation also proposes:

- To be retrospective and unwind financial arrangements that may have occurred up to decades earlier,
- That the third party satisfy the trustee that previous transactions and transfers were outside the scope of the new legislation. This effectively shifts the burden of proof from being one where the trustee must demonstrate past actions designed to defraud, to one where there is almost an assumption of fraud and that the third party must demonstrate that an illegal act did not occur and,
- That orders and arrangements approved by the Family Court be disregarded in the Trustees assessment of which assets may be caught within the net of this new legislation.

The Impact of such Legislation

Whilst past events suggest that some action, both legislative and regulatory, has been required to reduce the incidence of tax avoidance and non-compliance with bankruptcy provisions, we generally believe that the above legislation is far too broad in its application and potential impact.

From a practical perspective, many innocent parties, referred to as 'third parties', will be adversely affected in circumstances that are not warranted.

In addition to this, the above laws will most definitely discourage certain professionals from practicing, provide overzealous litigants with the opportunity to pursue those less able to defend themselves in litigation and also result in the further sustained pressure of insurance premiums for not only professionals, but many family businesses.

1. Legitimate family arrangements

The above laws will impact on family situations whereby parents have in the past transferred businesses or other property to their children for no reason other than to financially assist their family. For example, if parents were to provide financial support to their children, but later faced financial difficulty and potential bankruptcy, then the assets of their children would most likely also be at risk.

2. Impact on professionals

Doctors, dentists, architects, engineers and many other professional consultants who work in partnership and share joint and several liabilities will also be at risk. If a partnership is faced with a financial crisis and an individual partner is declared bankrupt, many assets held by his family and associated entities could be available to his trustee. This could be the case many years after the event and even if the assets have been held by a third party for some time and maintained by them for a period. This could also be the case many years after the event when the partner is retired.

3. Conflict with the Family Law Court

At present, the Family Law court recognises the non-financial contribution of non working spouses in the maintenance of family assets and property held by one or both parents.

However, this legislation seems to take no notice of this established precedence and its impact on family financial arrangements could be most damaging.

A Family Law court order made to fairly separate the assets of a husband and wife, could be subsequently overturned years later with the consequences being, quite clearly, financially disastrous for many ordinary, unsuspecting families and particularly single parent families.

4. Non Executive directors

The Corporations Law has been widely expanded over recent times to promote good corporate governance and outline the responsibilities of directors. Some may also say that the legislation has lifted the standard of Australian directors and business can only benefit from this.

However, the above legislation would provide an enormous disincentive to individuals to act as non-executive directors.

For a director to risk not only his own assets, but also those of his family and others financially connected to him, would most likely dissuade many from taking directorship roles and this would only deprive Australian corporations of their skills and experience.

5. Retrospectivity

This legislation is designed to capture financial arrangements that may have been organised years before its enactment.

This places enormous pressure on professional advisers and others who may have relied on previous legislation and rules that were acceptable at the time when providing advice to their clients.

This new legislation, by design, will render many legitimate financial arrangements as ineffective and inappropriate.

Again, the impact of many financial arrangements could be overturned or attacked by a trustee, and farmers and rural based families that use trusts and partnerships to legitimately transition the ownership of family assets could be at risk.

6. Australian Small Business

Australia's economy, to a certain degree, is driven by the prosperity and initiative of small business. But this business sector appears the one most likely to be hit by the proposed new laws.

In every case where a business fails, a trustee in bankruptcy will have the chance to trawl through the financial arrangements of the bankrupt's family and third party arrangements in an attempt to retrieve funds. Of course, in some cases there may be a perfectly legitimate reason to do this, but in many more the impact would be unjust and unfair, especially if they could not afford the costs of accessing professional advice.

The financial disincentive for people to start and expand businesses will be too great and this quite clearly could have an effect on our economy.

A Practical Approach

As mentioned, we understand that the past actions of others have resulted in the government acting quickly to prevent similar future actions.

However, we believe that the approach taken is too harsh and far reaching. The proposed legislation has negative consequences that far outweigh its intended benefits and, as professionals, we believe the impact on ordinary Australians and small business could be enormous.

Recent professional regulation by industry groups has helped to reduce the incidence of people deliberately avoiding and, arguably, defrauding their creditors. As has been recently seen, certain national Law Societies now make it impractical for their members to practice whilst insolvent and this action should be an adequate deterrent for members to abuse the provisions of bankruptcy and taxation legislation.

Any changes to existing legislation should focus upon:

- The circumstances relating to the high profile persons who had gone bankrupt.
- The fact that such abuses were by a very small minority.
- The fact that there are provisions in the existing Bankruptcy Act to deal with fraudulent activity designed to defeat creditors. If there are deficiencies in these provisions, they need to be identified with precision and any amendments recommended should also be precise in dealing with such deficiencies.

It is the right and the responsibility of every Australian to safeguard his or her assets while solvent to ensure adequate funds for retirement. The proposed legislation, however, is a time bomb that would devastate all Australian businesses and professionals.

This legislation must not be enacted in its current form. Its impact is too damaging on innocent Australians who are caught in circumstances that aren't worthy of the proposed punishment.

Should you have any questions or queries regarding the issues raised, please feel free to call our partner, Peter Constantinou on 9481 1448.

Yours sincerely

GRANT THORNTON
Perth Office