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Bills Digest

No. 151 2001–02

Bankruptcy (Estate Charges) Amendment Bill
2002

ISSN 1328-8091

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Published by the Department of the Parliamentary Library, 2002

I N F O R M A T I O N A N D R E S E A R C H S E R V I C E S

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No. 151 2001-02

Bankruptcy (Estate Charges) Amendment Bill 2002

Nathan Hancock and Mark Tapley
Law and Bills Digest Group
24 May 2002

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Bankruptcy (Estate Charges) Amendment Bill 2002

Date Introduced: 21 March 2002

House: House of Representatives

Portfolio: Attorney-General

Commencement: Royal Assent. However, items 1 to 10, 12 and 13 of Schedule 1 commence immediately after the commencement of the *Bankruptcy (Estate Charges) Amendment Act 2001*.

Purpose

To

- amend the *Bankruptcy (Estate Charges) Act 1997* to close an apparent loophole in relation to charges on amounts received by solicitors acting as controlling trustees.
- amend the *Bankruptcy (Estate Charges) Amendment Act 2001* to tie its commencement to the proposed *Bankruptcy Legislation Amendment Act 2002* rather than the now lapsed Bankruptcy Legislation Amendment Bill 2001.

Background

Two Bills were introduced in 2001 to amend bankruptcy legislation. The Bankruptcy Legislation Amendment Bill 2001 aimed to make various changes designed to make bankruptcy more difficult, encourage the use of alternatives to bankruptcy and to address abuses of the bankruptcy system. The Bankruptcy (Estate Charges) Amendment Bill 2001 sought to make various adjustments in respect of 'realisation' and interest charges.

The Realisation Charge

Under section 6 of the *Bankruptcy (Estate Charges) Act 1997*, a realisation charge is payable *by the trustee*, whether the Official Trustee or a private registered trustee, to the Commonwealth. The charge is payable on the administration of all bankrupt estates including deceased estates, and also in relation to deeds of assignment, deeds of arrangement or compositions entered into by debtors under Part X of the *Bankruptcy Act*

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1966. It is not payable on Part IX debt agreements or compositions or schemes of arrangement under Division 6 of Part IV of the *Bankruptcy Act 1966*.

Interest Charge

Under section 169 of the *Bankruptcy Act 1966*, a trustee is obliged to pay any trust monies that he or she receives into an interest bearing account. The trustee is entitled, in his or her personal capacity, to any interest earned less bank fees and charges paid or payable. Under section 5 of the *Bankruptcy (Estate Charges) Act 1997* these interest payments are payable by the trustee as a charge to the Commonwealth.

Controlling Trustees

The main issue addressed by this Bill is an apparent loophole in the application of charge obligations to solicitors acting as 'controlling trustees' under the *Bankruptcy Act 1966*.

Generally, the *Bankruptcy Act 1966* provides for two types of trustees in bankruptcy. These are the Official Trustee in Bankruptcy and persons who are registered as trustees under the Act. However, there is a third category of person who may perform a similar role in relation to arrangements with creditors outside bankruptcy under Part X. Under section 188 a debtor may, before their property is sequestrated, authorise the Official Trustee, a registered trustee, or a solicitor to act as a 'controlling trustee' for the purpose of calling a meeting of the creditors and taking control of the debtor's property. In performing these functions, these trustees have the same obligations as other trustees (section 210).

Thus, all 'controlling trustees', including solicitors, are subject the various obligations under the *Bankruptcy Act 1966*. But are all 'controlling trustees', specifically solicitors, subject to the charge obligations under the *Bankruptcy (Estate Charges) Act 1997*?

The obligation to bank trust monies and the entitlement to interest, less fees and charges are expressed to apply to 'controlling trustees', including solicitors, 'as if the debtor were a bankrupt' and 'the controlling trustee were the trustee of the estate of the bankrupt debtor'. However, the obligation to pay the realisation charge is only imposed in relation to monies 'received by a trustee' (subsection 6(1)). Similarly, the obligation to pay the interest charge only applies in relation to interest 'to which a trustee is entitled' (subsection 5(1)).

Under section 4 of the *Bankruptcy (Estate Charges) Act 1997*, any expressions used in that Act have the same meaning as in the *Bankruptcy Act 1966* 'unless the contrary intention appears'. While 'trustee' is not defined, the expression 'the trustee' includes various trustees in bankruptcy and a trustee of a deed or composition under Part X (*Bankruptcy Act 1966*, section 5). Implicitly, none of these include a 'controlling trustee' because their functions exist outside bankruptcy and precede deeds and compositions under Part X.

A strict reading of the *Bankruptcy (Estate Charges) Act 1997* might suggest that, while solicitors may act as controlling trustees, they need not pay realisation and interest charges because they are not 'trustees' for the purposes of the *Bankruptcy Act 1966*.

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Moreover, a strict reading might suggest that the other trustees (the Official Trustee and registered trustees) need not pay these charges because they are not 'trustees' when they act as 'controlling trustees' for the purposes of the *Bankruptcy Act 1966*.

However, at least two contrary arguments may be made. First, it seems clear from the text of *Bankruptcy (Estate Charges) Act 1997* that the obligation to pay realisation and interest charges is intended to apply to controlling trustees (subsection 5(2)). Moreover, there is no suggestion from the scope purpose and object of the relevant provisions that solicitors were intended to be excluded. In other words, a 'contrary intention appears' for the purposes of interpreting 'trustee'. Second, while the expression 'the trustee' clearly includes trustees in bankruptcy it also includes, paradoxically, 'the trustee of a trust'.¹ A solicitor acting as a controlling trustee would, in common law, be a trustee of a trust.

On the other hand, extrinsic materials surrounding the relevant provisions *may* suggest that the obligation to pay charges was only ever intended to apply to registered trustees.² At the same time, the focus on registered trustees may be explained by the fact that, prior to the relevant amendments, solicitors were not able to act as 'controlling trustees'.³ On this basis, it would be understandable for the extrinsic materials only to refer to registered trustees.

Further Background

A more complete background to these provisions is given in the Bills Digest of the Bankruptcy Legislation Amendment Bill 2001.⁴

Main Provisions

Schedule 1, items 1–10 amend the *Bankruptcy (Estate Charges) Act 1997* to provide that the realisation and interest charges are payable not by a 'trustee' but by a 'person' in relation to amounts received or interest entitlements under the *Bankruptcy Act 1966*.

Items 12 and 13 provide that these amendments apply to amounts that are received or interest entitlements that arise after the commencement of the amendments.

Item 11 amends the *Bankruptcy (Estate Charges) Amendment Act 2001* to ensure that its commencement is tied to the commencement of the proposed *Bankruptcy Legislation Amendment Act 2002*.

Concluding Comments

From a layperson's perspective it might be reasonable to wonder how the loophole could have arisen. After all, as indicated, a solicitor acting as a controlling trustee would, as a matter of common law and under statutes applying to legal practitioners, be deemed to be

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a trustee of the debtor's estate. Moreover, it is worth noting, they would be subject to various obligations in respect of banking trust monies and dealing with the interest earned. For present purposes, the key obligations are that solicitors must bank trust monies and rarely, if ever, are entitled to receive interest from those monies in their personal capacity.⁵

It is against this background that the relevant amendments were framed. The *Bankruptcy Legislation Amendment Act 1997* and the *Bankruptcy (Estate Charges) Act 1997* permitted solicitors to act as controlling trustees and displaced the rules relating to trust accounts. It gave them a personal right to interest which was meant to be caught by the interest charge.

The intention, as demonstrated by the treatment of registered trustees, was to divert any interest on trust monies away from potential beneficiaries, including debtors, creditors and law societies (and their beneficiaries, such as community legal centres),⁶ to the Insolvency and Trustee Service of Australia (ITSA). Indeed, the stated intention of the Government was to introduce 'a package of measures ... that increased cost recovery for [ITSA]'.⁷

However, given the loophole, the effect may have been to give solicitors an unusual gift which could not be recovered by debtors, creditors, law societies or the Commonwealth. This might be expected to frustrate all stakeholders, except perhaps insolvency solicitors.

As suggested, there may be a similar argument in relation to registered trustees. And, as indicated by the provisions above, similar considerations apply to the realisation charge.

Moreover, if controlling trustees cannot be compelled to pay the interest and realisation charges, it might be argued that any solicitor, and potentially any registered trustee, who has paid those charges between 1997 and 2002 ought to be able to recover those amounts. In this context, it may be significant that the financial impact of the loophole is unclear.

Endnotes

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- 1 Section 5, *Bankruptcy Act 1966*, definition of 'the trustee', paragraph (e).
 - 2 'The interest charge is a new charge imposed in respect of interest earned by funds held in trust by registered trustees in relation to estates and other matters administered by them. The introduction of the proposed charge will place these estates on the same footing as estates administered by the official trustee, where funds held on behalf of estates and debtors are held in the common investment fund and the interest is paid to Consolidated Revenue': *Bankruptcy (Estate Charges) Bill 1996, Explanatory Memorandum*, p. 1. A similar reference to 'registered trustees' appears in the Second Reading Speech: Daryl Williams MP, *Bankruptcy (Estate Charges) Bill 1996, Second Reading Speech, House of Representatives, Debates*, 9 October 1996, p. 5087.
 - 3 '[Prior to the 1997 Amendments] section 188 of the Act provide[d] for a debtor to sign an authority in accordance with the prescribed form authorising a registered trustee to call a

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meeting of the debtor's creditors and to take control of the debtor's property. The debtor [could] also execute an authority in favour of a solicitor. The solicitor's functions [were] to call a meeting of the debtor's creditors [ie the solicitor never became a trustee pursuant to bankruptcy legislation]': Bankruptcy Legislation Amendment Bill 1996, *Explanatory Memorandum*, pp. 163-164.

- 4 Katrine Del Villar, Bankruptcy Legislation Amendment Bill 2001, [Bills Digest No. 8 2001-2002](#).
- 5 For example, under the *Legal Practitioners Act 1970* (ACT) all monies received by a solicitor from or on behalf of a client are deemed to be held in trust (section 87). However, the solicitor may exercise a lien over those funds in respect of his or her fees and charges. All trust monies must be paid into a trust account (section 91). Ordinarily, they are paid into the solicitor's general trust account. However, they may also be paid into a special trust account or they may be invested on the client's instruction (section 92). Significantly, the solicitor *must* seek instructions from the client on this issue where the balance on the trust account is likely to exceed \$5 000 over a 3 month period (section 93).
- 6 As indicated, trust monies are ordinarily deposited in a solicitor's general trust account, particularly if the funds are held for less than 3 months. Interest from trust accounts, or amounts in lieu of interest earned, are paid to the Law Society of the Australian Capital Territory under section 129 of the *Legal Practitioners Act 1970*. The Law Society customarily makes payments to organisations such as Community Legal Centres. Assuming that a controlling trust lasted for less than 3 months, most of the interest payable to the controlling trustee would, if not for the amendment to section 169 of the *Bankruptcy Act 1966* be payable to the Law Society, and ultimately to beneficiaries of the Law Society.
- 7 Daryl Williams MP, Bankruptcy (Estate Charges) Bill 1996, Second Reading Speech, House of Representatives, *Debates*, 9 October 1996, p. 5087.

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