



Bankruptcy Legislation Amendment (Anti-Avoidance) Bill 2005

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Law and Bills Digest Section

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Bankruptcy Legislation Amendment (Anti-Avoidance) Bill 2005

Date introduced: 7 December 2005

House: House of Representatives

Portfolio: Attorney-General

Commencement: Sections 1–3 commence on the day of Royal Assent. Schedule 1 commences on the 28th day after the day of Royal Assent.

Purpose

The Bill seeks to make amendments to the *Bankruptcy Act 1966* (the Act) to strengthen provisions allowing the trustees of bankrupts to ‘claw back’ or recover property disposed of by the bankrupt prior to the bankruptcy.

Background

Early in 2001 Paul Barry reported in the *Sydney Morning Herald* that ‘a number of high-flying Sydney barristers are abusing the tax system’.¹ According to Barry, these barristers ‘repeatedly fail to meet tax demands, typically do not lodge tax returns, rack up debts of up to \$2 million, and then seek shelter in bankruptcy, which wipes out their debts’.² The paper identified barristers who were bankrupt and owed substantial sums to the Australian Tax Office as well as to other creditors but who enjoyed the use of assets owned by third parties, typically their wives or family trusts. Less than a month later the Commonwealth Attorney-General and Assistant Treasurer issued a joint news release titled ‘bankrupt lawyers’ in which it was announced that a taskforce had been established to determine whether any changes were needed to the bankruptcy and taxation laws to ensure that people are prevented from using bankruptcy as a means of avoiding their tax obligations.³

The recommendations of the Taskforce⁴ established by the Federal Government in March 2001 formed the basis of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004 (BLAAAMB), an exposure draft of which was released on 14 May 2004 by the Attorney-General.⁵ The Attorney-General advised that the Bill would make changes under which ‘the trustee in bankruptcy will be able to recover assets held in the name of the bankrupt’s spouse, or that of another party, where the bankrupt has paid for and uses the asset’.⁶

The exposure draft of the BLAAAMB was the subject of an inquiry by the House of Representatives Standing Committee on Legal and Constitutional Affairs. In submissions to the Inquiry, much criticism was made of the proposed changes including that they:

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- represented a disproportionate response
- would unfairly impact on asset protection arrangements
- were retrospective in effect
- would place an onerous burden on asset owners by reversing the onus of proof, and
- were unconstitutional.

Details of these criticisms and the Committee's response can be found in Chapter 3 of the report available here: <http://www.aph.gov.au/house/committee/laca/bankruptcy/report.htm> The Committee recommended that the proposals in the BLAAAMB relating to the proposed new claw back provisions be abandoned, and that the Attorney-General undertake further consultation with a view to strengthening the existing provisions in sections 120 and 121 of the Bankruptcy Act.⁷

The Government responded by withdrawing the exposure draft of the BLAAAMB and revising it, in consultation with relevant stakeholders.⁸ This Bill, the Bankruptcy Legislation Amendment (Anti-Avoidance) Bill 2005, is the result of that process of consultation.

Main Provisions

Amendment to section 77C of the Bankruptcy Act

Schedule 1, item 2 adds **new subsection (3)** to section 77C of the Act. Section 77C empowers an official receiver to require any person to provide information connected with the performance of the receiver's functions under the Act. A power to require a person to give evidence on oath is included. The intention of the new subsection is to ensure that any transcript of proceedings carried out under section 77C can be used in proceedings relating to the bankrupt estate.⁹

Amendments to section 120 of the Bankruptcy Act

Section 120 of the Act makes certain transfers of property by a person who later becomes bankrupt (the transferor) to another person (the transferee) void as against the trustee of a bankrupt. Currently subsection 120(3) has the effect that a transfer will not be void where it occurred more than two years prior to the bankruptcy and the transferee proves that, at the time of the transfer, the transferor was solvent. **Schedule 1, item 7** repeals the existing subsection 120(3) of the Act and replaces it with a new subsection. The new subsection has the same effect as the current subsection except that it provides that where the transfer was to a 'related entity' of the transferor, then it must have occurred more than 4 years prior to the bankruptcy, if it is to be preserved. The term 'related entity' is defined quite broadly in section 5.

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The policy considerations behind this amendment are that it is common for people to be aware that they are likely to become bankrupt more than two years before the event and also it is more likely in practice that assets will be transferred to related parties when seeking to avoid creditors than to strangers. It is thought that currently, there is too much scope in the period between two and four years for a person to deliberately divest themselves of assets.¹⁰

Schedule 1, item 8 adds to section 120 **subsection (3A)**. The new subsection provides a rebuttable presumption, for the purposes of subsection 120(3), that the transferor was insolvent at the time of the transfer if it is established that the transferor had not kept and preserved proper accounts and records in relation to their business.

Subsection 120(1) and 120(4) refer to ‘consideration’. Subsection 120(1) renders transfers void where they are made within 5 years before the bankruptcy and where there was no consideration (payment of any kind) by the transferee or where the consideration given was below market value. Subsection 120(4) provides that where a transfer is void a trustee must repay to the transferee any consideration given for the transfer. Subsection 120(5) lists certain things which are taken not to be ‘consideration’ for the purposes of subsection (1)&(4). **Schedule 1, item 10** adds to subsection 120(5) a **new subparagraph (e)**, which provides that the right to live at the transferred property, if given by one spouse to another, does not constitute ‘consideration’ unless it relates to a transfer, settlement or agreement under the *Family Law Act 1975*.

Amendments to subsection 121 of the Bankruptcy Act

Section 121 of the Act is similar in effect to section 120 but provides that transfers are void where they are specifically for the purpose of defeating creditors. Subsection 121(4) creates exceptions in certain cases, such as where the transferee did not know that the transferor’s purpose was to avoid creditors. **Schedule 1, item 12** inserts the phrase ‘or could not reasonably have inferred’ after ‘know’ in subsection 121(4)(b). This has the effect of tightening the scope of the exceptions so that a test of reasonableness is added to the person’s claim that they did not know the reason for the transfer. In the Explanatory Memorandum this is referred to as ‘wilful blindness’ on the part of the transferee.¹¹

Schedule 1, item 13 adds to section 121, **subsection (4A)** which has the effect of adding the same rebuttable presumption of insolvency in relation to section 121 as **item 8** does in relation to section 120 (see above).

Schedule 1, item 15 has the same effect in relation to section 121 as item 10 does in relation to section 120 (see above).

Amendments to division 4A of Part VI

One possible method of avoiding creditors is for a person to accumulate wealth in the name of another person or entity, but retain the use or benefit of that property themselves.

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Division 4A addresses this situation in respect of entities by allowing the trustee of a bankrupt to apply to the court for an order vesting property of the entity in the trustee. The Bill proposes a number of amendments to the division to:

- Extend the time period to which the division applies (the ‘examinable period’);
- Ensure that the provisions of the division apply to situations where the relevant property is held in the name of a person as well as an entity;
- Widen the notion of benefit in the division to ensure that it covers circumstances where there is a benefit to the bankrupt derived directly or indirectly.

Schedule 1, item 17 inserts new **section 139CA** into the Act. This section provides a definition of ‘examinable period’ for the purposes of the division. The applicable period will be four years before the commencement of the bankruptcy to the day the application is made, where the order is sought against a related entity of the bankrupt, and 2 years before commencement of the bankruptcy to the day the application is made, in other circumstances. Both of those times can be extended as far back as five years before the commencement of the bankruptcy to the date on which the bankrupt became insolvent.

Schedule 1, item 18 adds words to section 139D limiting the operation of that section to circumstances where an order is sought in relation to a respondent other than a natural person.

Schedule 1, item 19 adds the phrase ‘whether directly or indirectly’ after the word ‘derived’ in the phrase ‘derived a benefit from’ in subparagraph 139D(1)(d).

Schedule 1, item 20 adds new **section 139DA**. This section deals specifically with the circumstance where applications are made in respect of an ‘entity’ that is a natural person.

Schedule 1, item 22 inserts new **section 139EA**. This section has the same effect as **section 139DA**, except that it deals with circumstances where the value of the relevant property has *increased* as a result of contributions from the bankrupt, as opposed to where it was *acquired* by means of such contributions.

Concluding Comments

The provisions contained in the Bill will strengthen the ‘claw back’ provisions in the Bankruptcy Act by clarifying some of the existing provisions and expanding their application. They represent, however, much less of a radical strengthening of the provisions than was proposed in the BLAAAMB. Whether these changes will have a significant impact on the practice that was the initial catalyst for concern, that of high-income professionals using bankruptcy to avoid their debts, is a matter for debate.

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Endnotes

1. 'Rich lawyers dodging income tax', *Sydney Morning Herald*, 26 February 2001.
2. *ibid.*
3. Daryl Williams MP and Senator Rod Kemp, *Joint News Release*, 22 March 2001.
4. Australian Taxation Office, Insolvency and Trustee Service Australia and Treasury, 'Joint Taskforce Report on the use of bankruptcy and family law schemes to avoid payment of tax', Attorney-General's Department, January 2002.
5. Philip Ruddock MP, 'Tougher laws to stop bankrupts living the high life', *News Release*, 14 May 2004.
6. *ibid.*
7. Recommendations 2 and 3.
8. Government Response to the Standing Committee on Legal and Constitutional Affairs' Report of the Inquiry into the exposure draft of the Bankruptcy Legislation Amendment (Anti-Avoidance and Other Measures) Bill 2004, p. 2.
9. Explanatory Memorandum, Bankruptcy Legislation Amendment (Anti-avoidance) Bill 2005, p.5.
10. *ibid.*, p. 3.
11. *ibid.*

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