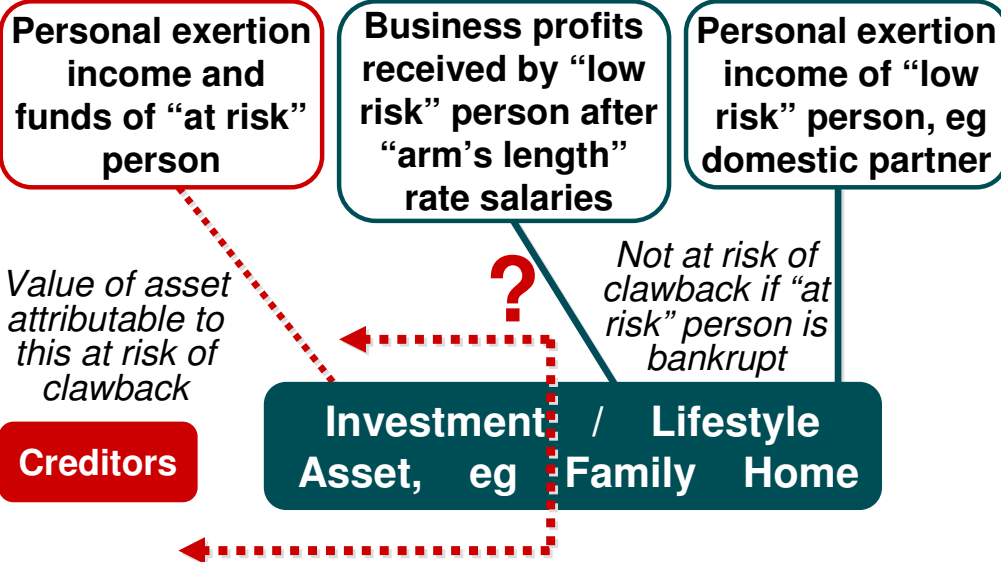


Bankruptcy Clawback



Approach of Courts to Assets Held by Spouses and Family Entities

The comments of High and Federal Court judges concerning spouse and family trust ownership in the 2006 decisions in *Cummins* and *Richstar* indicate that the Federal Courts, when applying section 121 of the *Bankruptcy Act 1966*, will be increasingly likely to look past the formal legal ownership of assets held by:

- Spouses;
- Family companies; and
- Trustees of family trusts (and similarly structured trusts such as fully or partly hybrid unit trusts).

Instead the Federal Courts are likely to take an approach more akin to the approach taken by the Federal Court in family law cases and choose to look at:

- (In the case of family trusts, companies and other entities) who effectively controls the trust and the power of selection of the trustee (in Family Court cases, the Courts usually treat trusts administered by professional advisors such as lawyers and accountants as being controlled by the advisor’s client);
- The sources of funding for the assets so held; and
- Just how expenditure has been incurred in respect of maintaining those assets, eg the payment of mortgages, repairs and rates, with a view to determining the true beneficial ownership of the assets.

This approach to the administration of bankruptcy law warrants a change of approach to the administration of spouse and family trust owned assets with a view to ensuring that expenses associated with these assets do not come out of “at risk” funds. Examples of “at risk” funds include personal income or savings of the “at risk” person or income or savings generated from personal exertion of the “at risk” person. (The clawback of assets in superannuation funds by contrast is likely to be limited to large contributions made with a view of defeating creditors.)

Clawbacks – *Bankruptcy Act 1966*

- **s116(1)** “Divisible” property (*must be capable of assignment*)
- **s116(2)** Excluded assets such as superannuation & life insurance (see Reg 6.03 for household items)
- **s120** Undervalued transactions within 4 (or 5) years of earliest “act of bankruptcy”
- **s121 & s121A** General anti avoidance provisions
- s128B & 128C** Exceptional super contributions
- s139A-139H** Related entity/person transactions



Anti Avoidance Provisions

In addition to the specific time period provisions in section 120 of the *Bankruptcy Act 1966* and the “clawback” of certain assets, there are a number of anti-avoidance provisions in the same Act that should be considered when transactions are being contemplated, eg:

- Sections 121 and 121A – transactions entered into with the main purpose of defeating the claims of creditors.
- Sections 128B and 128C – exceptional contributions made to superannuation by fund members and employers.
- Sections 139A to 139H – special anti-avoidance provisions for transactions involving related entities and related persons, eg a domestic partner.

For example, the anti-avoidance provisions apply to the payment of less than commercial wages to a person who subsequently becomes bankrupt by a non-arm’s length entity during the section 120 “clawback” period (usually 4 or 5 years from the earliest act of bankruptcy in a six month period prior to the lodgment of the creditors’ or debtor’s petition to the Court) leading up to the date of bankruptcy.

Section 121 – General Anti-Avoidance Provisions

For people familiar with the income tax legislation, section 121 has a similar role in the Bankruptcy legislation to Part IVA of *ITAA 1936* (the latter applying a sole or dominant purpose test. A pivotal provision in section 121 is paragraph 1(b) which renders void transactions for bankruptcy purposes where:

....”the transferor’s main purpose in making the transfer was:

- (i) to prevent the transferred property from becoming divisible among the transferor’s creditors; or
- (ii) to hinder or delay the process of making property available for division among the transferor’s creditors.”

“Clawbacks” of Asset Transfers – s120

Definition of **transfer** includes

- # Gifts and forgiveness of debts
- # Guarantees and mortgages
- # Preference dealings

Separate rules for super contributions

Clawback periods

None – arm’s length terms/fully commercial

4 years – gifts with no immediate “cloud”

Otherwise 5 years (no limit at all for fraud)

Operation of the Exemptions in Section 120

Subsection 120(1) sets up the general rule that transfers can be clawed back if made within a 5 year period preceding the act of bankruptcy. The succeeding subsections set out a series of exemptions from that general rule, including:

- Subsection (2) – payments of tax and maintenance and payments under a debt agreement;
- Subsection (3) – transfers by a solvent person within 4 years of bankruptcy;
- Subsection (4) – refunds of consideration for transfers that have been held to be void, eg refund of a payment that was for less than full consideration, based on market values;
- Subsection (5) makes it clear that promises to marry and natural love and affection are not consideration; and
- Subsection (6) provides protection for arm’s length successors in title.

Contributions to the trustee of a superannuation fund are subject to separate provisions, ie sections 128B (for contributions by a member prior to bankruptcy) and 128C (for contributions by a 3rd party such as an employer).

Bankruptcy Clawback – Further Reading

Australian Master Estate Planning & Succession Guide – Chapter 12

The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/epss/pocket-summaries

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Further Reading

- The 1st edition of the **Australian Master Estate Planning and Succession Guide** by Allan Swan is scheduled to be published by **CCH** in 2011.
- The 1st edition of **You Can't Take It With You** by Andrew Simpson was published by **Wrightbooks** in 2009.
- The 5th edition of **Tax Issues in Family Law Property Settlements** – The Difference Between Hacking and Carving by Peter Szabo was published by **MOORESLEGAL** in 2008.

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- Asset Protection Planning (includes all 3 pages of this Pocket Summary)
- Blended Families
- Business Structures Overview
- Estate Planning – Key Cases and Rulings
- Estate Planning – Practical Case Studies for 2010
- Estate Planning – Tax and Strategic Issues
- Funding Estate Planning
- Ruling from the Grave
- SMSFs – Planning Issues
- Superannuation Death Benefits
- Superannuation Overview
- Testamentary Trusts
- Trusts – Income and Capital Distributions
- Trusts – The A-Z (1).

Contact Allan 03 9843 2153 for further information regarding on the content of the topics, the fees charged and to schedule a presentation, workshop or seminar.