

Part B The Collection of Taxation Debts**16 BANKRUPTCY ACT – PART X PERSONAL
INSOLVENCY AGREEMENTS**

The policy in this chapter is to be followed by Tax Office staff. We have made every effort to ensure it is technically accurate, but in the interests of clarity it has been written in 'plain English' and should not be read or interpreted like legislation. If you feel that something in the chapter is wrong or misleading, please advise the Tax Office.

Date of effect: 4 July 2006 *(This replaces the 2003 version.)*

16.1 PURPOSE

16.1.1 This chapter:

- deals with provisions under the *Bankruptcy Act 1966* that enable debtors to present creditors with proposals under which they would be required to pay less than the full amount of a debt in full and final settlement of that debt; and
- sets out the matters the Commissioner will take into account when deciding how to vote at a meeting called to consider and vote on such proposals offered by debtors.

16.2 LEGISLATION

16.2.1 Part X of the Bankruptcy Act provides a mechanism for an individual debtor to avoid formal bankruptcy.

16.3 INTRODUCTION

16.3.1 Part X of the Bankruptcy Act exists to:

- (i) provide relief for an insolvent debtor from paying debts immediately, or in full, or from the need to meet them as and when they fall due;
- (ii) treat all unsecured creditors equally and to provide for fair and equitable distribution of the proceeds; and
- (iii) permit examination and investigation of the debtor's affairs, to ensure that creditors receive the benefits of all available assets.

16.3.2 Part X permits debtors and creditors to determine how a debtor's affairs should be administered outside the rigid code of bankruptcy - that is, Part X provides an alternative to bankruptcy. It provides a debtor with a relatively simple process by which a proposal can be presented to creditors and have them focus on the debtor's financial problems. If the proposal is accepted and the debtor enters into a Part X arrangement, creditors appoint a trustee to act on their behalf to realise assets, collect moneys payable and pay dividends.

16.3.3 Part X provides a procedure by which non-corporate debtors and their creditors may reach arrangements that:

- (i) avoid bankruptcy and the associated need for a creditor to pursue a sequestration order;

- (ii) retain many of the requirements and protections of the Bankruptcy Act, including the appointment of a trustee to look after the interests of all creditors and the equitable distribution of property amongst creditors;
 - (iii) provide relief to the debtor so that the debtor may continue or start afresh;
 - (iv) are binding on the debtor and creditors; and
 - (v) can be initiated simply and without recourse to the courts (although documents initiating a Part X personal insolvency agreement must be filed with the Registrar for public record).
- 16.3.4 Prior to the passage of the *Bankruptcy Legislation Amendment Act 2004* in June 2004, there were three different forms a Part X arrangement could take – a deed of assignment, a deed of arrangement, or a composition. However, since June 2004, those three types of deeds or compositions have been replaced by a hybrid agreement, known as a *personal insolvency agreement*, which incorporates elements of each of the three pre-existing types.
- 16.3.5 Personal insolvency agreements include standard provisions which need to be voted upon by creditors. Those standard provisions include the following matters:
 - the property or income of the debtor to be dealt with in the agreement (including whether this includes ‘after-acquired’ property);
 - whether the antecedent transaction provisions would be available to recover any assets disposed of to third parties prior to the agreement;
 - whether the standard rules of distribution of dividends would apply, and if not, to set out the applicable rules;
 - whether the debtor is to be released from provable debts (fully or partially) and if a release can occur, to specify when this would happen.
- 16.3.6 When a personal insolvency agreement with creditors is proposed under the provisions of Part X, the Commonwealth has the same discretion as any other creditor to either agree to, or oppose, the proposal.
- 16.3.7 The personal insolvency agreement is completed when the debtor fulfils their obligations under the terms approved by the creditors.
- 16.3.8 In order for Part X to operate, a debtor must first execute an authority under section 188 of the Bankruptcy Act to appoint a controlling trustee, or a solicitor, to convene a meeting of creditors to consider the proposal. The creditors meet to determine if:
 - (i) a personal insolvency agreement will be accepted;
 - (ii) the debtor's property will be released from the control of the controlling trustee; or
 - (iii) the debtor will be directed to file a debtor's petition for bankruptcy.
- 16.3.9 At the meeting, the proposed personal insolvency agreement is discussed and may be amended. Creditors can only accept a personal insolvency agreement by the passing of a special resolution. A special resolution is a resolution carried by a majority in number and 75% by value of the creditors voting on the resolution and present personally, by

telephone, by attorney or by proxy at a meeting of creditors. If a special resolution is passed, it is binding on all creditors, including the Commissioner.

- 16.3.10 Secured creditors are permitted to vote only to the extent that their debt is not secured by the debtor's property. Changes introduced by the *Bankruptcy Legislation Amendment Act 2002* allow a creditor who holds security over property belonging to someone other than the debtor to vote for the full amount of their debt. For example, where the creditor's security is over the debtor's parents' home, rather than over the debtor's asset, the secured creditor is entitled to vote to the full extent of the debt owed by the debtor.
- 16.3.11 Trustees who call meetings on behalf of a debtor to consider a Part X proposal have certain duties imposed upon them by the Bankruptcy Act. They must furnish all creditors with details of the debtor's financial situation and all other proper and relevant information in time to enable the creditors to vote on the proposal at the meeting.
- 16.3.12 If the creditors vote against the proposal at the meeting, the meeting may also determine what role, if any, the trustee will continue to have in the matter. The meeting could ask the trustee to develop a new or modified proposal, or to vote for the release of the debtor's property from the control of the controlling trustee, or to vote that the debtor present their own petition in bankruptcy within seven days.

16.4 POLICY

- 16.4.1 A debtor has a number of avenues available under various laws that effectively provide for formal compromise or allow the Commissioner to accept payment of a debt over time. Generally, these avenues operate to protect debtors and, in the case of the bankruptcy laws, to protect the interests of all creditors, each of whom has the opportunity of voting on any compromise proposal.
- 16.4.2 The Commissioner's authorised representatives can register a vote at a creditors' meeting in favour of a proposal that provides for payment of less than the full amount in settlement of the debtor's liabilities, including the tax debts. Dividends of less than 100 cents in the dollar received from insolvency administrations are applied as a matter of law on a pro rata basis amongst each creditor. (*Turner Manufacturing Co. Pty Ltd v. Senes* (1964) NSW 692, *Thompson v. Hudson* (1871), 6 Ch. App. 320). When the dividend is received by the Tax Office, the Commissioner has discretion as to how to allocate the dividend towards various outstanding debts. (See chapter entitled 'Allocation of payments and credits') The dividend is generally apportioned towards each component of the proof of debt (including any accumulated HEC debts) on a pro rata basis. The remaining balance of these debts (apart from the balance of the accumulated HEC debt) is not pursued, given that they are now irrecoverable at law (see chapter entitled 'Deciding not to pursue recovery of taxation debts').
- 16.4.3 While each case must be considered on its individual facts, it can be generally accepted that the Commissioner will support arrangements that have no adverse features (discussed below) and which can provide the Commonwealth with no lesser proportion of the provable debt within a reasonable period than would occur under a bankruptcy.

- 16.4.4 When deciding whether a proposed personal insolvency agreement has any adverse features, the Commissioner will have regard to all relevant matters including, but not limited to:
- (i) any legal advice which may have been obtained by the Commissioner;
 - (ii) the contents and comprehensiveness of relevant reports (ie regard should be had to both the contents of the report and any relevant omissions);
 - (iii) the adequacy of those reports;
 - (iv) any apparent antecedent transactions or voidable dispositions which might be unable to be pursued if the proposal were to be accepted;
 - (v) any liabilities not yet established, such as unissued assessments, outstanding returns or activity statements;
 - (vi) future income which may be assessed for income contribution purposes;
 - (vii) whether the debtor has made appropriate arrangements to meet future tax liabilities as they fall due over the course of the arrangement;
 - (viii) in the case of a debtor who is suspected of being less than candid about their financial affairs, the fact that the personal insolvency agreement may not provide the same investigative powers as are available to a trustee in bankruptcy;
 - (ix) the debtor's taxation compliance history, and the compliance history of related entities;
 - (x) the likelihood that the proposals put forward will be achieved;
 - (xi) the maintenance of any priority the Commissioner may have in a bankruptcy;
 - (xii) other matters that are considered to be of public interest or which reasonably question the fairness and appropriateness of voting in support of proposals, particularly where the consequence of those proposals is the removal of statutory powers of investigation or examination;
 - (xiii) any association between the debtor and other creditors (including associations which involve an assignment of debt);
 - (xiv) the tangible benefit to the Commonwealth revenue that is expected to be gained from any proposed arrangement; and
 - (xv) the manner in which the proposal would distribute a dividend between all classes of creditors.
- 16.4.5 The Commissioner may seek external professional advice to assist in the collection and analysis of material relevant to such decisions. Officers should note the discussion on secrecy in the chapter entitled 'Accountability and review of decisions'.
- 16.4.6 While any arrangements approved under Part X of the Bankruptcy Act bind the Commissioner, appropriate relief will be sought by the Commissioner through the courts where it is considered that an

arrangement unreasonably disadvantages the Commonwealth revenue or includes adverse features.

- 16.4.7 A deed, composition, or personal insolvency agreement is completed when the debtor fulfils their obligations under the terms approved by the creditors. When all dividends to which creditors are entitled have been distributed, any remaining balances owing up to the date of execution of the deed or personal insolvency agreement or acceptance of the composition are irrecoverable at law. This has an important effect on the application of any excess credits, such as credits for tax instalment deductions.
- 16.4.8 Under a deed of assignment the debtor is released from their provable debts when the deed has been duly executed by both the debtor and the trustee (section 230 of the Bankruptcy Act). Therefore, any excess credits arising after the execution of the deed will be refunded.
- 16.4.9 The execution of a deed of arrangement or a personal insolvency agreement **may** provide for the debtor to be released from certain debts (section 234 of the Bankruptcy Act). If tax debts have been released by the deed any excess credits arising after that time will be refunded. If there is any tax debt which was in existence at the date of execution of the deed and which has not been released then credits arising may be applied in reduction of the debt.
- 16.4.10 A composition operates to release the debtor from all debts which would have been provable had a bankruptcy occurred. Any excess credits arising after the date of acceptance of the composition will be refunded.
- 16.4.11 Refunds in relation to years of income prior to the execution of a personal insolvency agreement or deed, or acceptance of a composition will be offset, even if the relevant assessment is made after these events.
- 16.4.12 With the introduction of the *Higher Education Funding Amendment Act 2001* (HEFAA 2001), and effective from 7 June 2001, HEC debts related to the period prior to the Part X arrangement which comprise the debtor's accumulated HEC debt and the unpaid part of the semester debts incurred prior to that time will be provable by the Commissioner, but will not be extinguished on completion of the terms of the arrangement or personal insolvency agreement, if they have not been fully recovered. The assessment debt, which is raised as part of the income tax assessment, will be provable and will be extinguished in line with the debts of other unsecured creditors. HEC debts related to the period after the Part X are not provable. It should be noted that, as per the *Student Assistance Act 1973*, accumulated Student Financial Supplement (SFSS) debts are not provable for the purposes of a Part X personal insolvency agreement, and nor are they extinguished upon completion of that agreement.
- 16.4.13 When considering personal insolvency agreements, the Commissioner needs to be alert for dispositions of property made by the debtor that would be void against the trustee under the antecedent transaction provisions should the debtor be declared bankrupt. Once a composition or deed of arrangement has been accepted, the trustee does not have recourse to the antecedent transaction provisions. However trustees do have recourse to these provisions if a deed of assignment is accepted. The standard provision relating to antecedent transactions within a personal insolvency agreement is decided upon by creditors and will

dictate the extent to which the trustee has recourse to the antecedent transaction provisions.

- 16.4.14 The relevant provisions of the Bankruptcy Act--sections 120 (undervalued transactions), 121 (transfers to defeat creditors) and 122 (preferences) -- were significantly amended by the *Bankruptcy Law Amendment Act 1996*, applicable to bankruptcies occurring on or after 16 December 1996. This Act amended sections 120, 121 and 122 by shifting the focus away from the intention of the parties to particular transactions to the nature of the transaction and the likely effect on creditors. Each section is outlined below. The onus is on the trustee in bankruptcy to establish that the pre-conditions of each section have been satisfied.
- 16.4.15 By the amended section 120 of the Bankruptcy Act, transactions are void against the trustee in bankruptcy if the transfer of property was for no consideration or a consideration less than the market value of the property at the time of the transfer and the transfer took place in the period beginning five years before the commencement of the bankruptcy. Certain transactions are exempted from section 120, including payments of tax under a law of the Commonwealth. Transfers are not void if the transfer took place more than 2 years before the commencement of the bankruptcy and the transferee (ie purchaser) can prove that at the time of the transfer the debtor was solvent. The term 'solvent' is defined in sub section 5(2) of the Bankruptcy Act to include a person who is able to pay all their debts as and when they become due and payable. Section 120 of the Bankruptcy Act does not affect the rights of a person who acquired property in good faith, and paid market value for the property. Finally, certain transactions are deemed to have no value as consideration for the purposes of section 120.
- 16.4.16 The amended section 121 of the Bankruptcy Act deals with transfers to defeat creditors. A transfer of property that is intended to defeat creditors is void if:
- the property would probably have become part of the debtor's estate or would probably have been available to creditors if the property had not been transferred; and
 - the main purpose in making the transfer was to prevent the property from becoming divisible property among creditors or to hinder or delay the process of making property available to creditors.
- 16.4.17 The debtor will be taken to have the main purpose of putting an asset beyond the reach of creditors if it can reasonably be inferred from all the circumstances that at the time of the transfer, the debtor was, or was about to become, insolvent. The Act provides for certain defences that prevent the transfer being declared void, eg the consideration given was at least the market value of the property. Section 121 of the Bankruptcy Act provides examples of certain things which offer no value as consideration.
- 16.4.18 Under section 122 of the Bankruptcy Act, a transaction by an insolvent debtor which gives a creditor a preference, priority or advantage over other creditors is void against the trustee. A transfer is not void if the transfer was made in the ordinary course of business, in good faith and for market value. This section may affect the Commissioner in that the Tax Office may receive a transfer of property (ie payment of monies) from a debtor who is insolvent and this may have the effect of giving the

Commissioner a preference over other creditors. In these situations, the trustee may demand repayment of the monies and the Commissioner would need to consider the defences under sub-section 122(2) of the Bankruptcy Act. For further information, see the chapter entitled 'Voidable transactions'.

- 16.4.19 The Commissioner may choose to provide information about the debtor to a controlling trustee or the trustee of a personal insolvency agreement, deed or composition where the Commissioner believes that it is reasonably likely that the provision of such information will lead to the Commissioner receiving a greater dividend or distribution from the insolvency process. Before disclosing any information, the Tax Office decision-maker must consider two separate pieces of legislation. The first is the relevant secrecy provision of the *Taxation Administration Act 1953* and similar provisions in other acts (eg section 16 of the *Income Tax Assessment Act 1936*). The decision is guided by Chapter 2 of the *ATO Receivables Policy* and, if disclosure is permissible under the relevant section, the Tax Office decision-maker may have a discretion to disclose information to the trustee. Where it is not clear that the information can be given without breaching secrecy provisions, advice should be sought from the Tax Office's Legal Services Branch.

16.5 TERMS USED

- 16.5.1 'Deed of assignment' takes a specific form and is a mechanism by which the debtor assigns all property (except after-acquired property) that would have been available to, or recoverable by, a trustee in bankruptcy. The trustee realises the assets for the benefit of creditors.
- 16.5.2 'Composition' is an offer to pay a sum (or sums) of money (or to provide property) in one or more instalments, not necessarily representing 100% of the amount owing, in full satisfaction of debts owed.
- 16.5.3 'Creditor' in this chapter means *unsecured creditor* unless otherwise specified.
- 16.5.4 'Deed of arrangement' is an arrangement which is neither a deed of assignment nor a composition. It can be tailor-made to suit the circumstances and might be anything from a supervised moratorium, where debts are ultimately to be paid in full, to an arrangement to carry on business providing for repayment only if profits are earned; or there may be a scheme to generate moneys combined with a minimum dividend requirement; or arrangements involving contributions, guarantees or securities from third parties. There may even be an assignment of assets combined with additional undertakings to repay from future income.
- 16.5.5 'Antecedent transactions, voidable dispositions' refer to certain transactions entered into prior to the presentation of the creditors petition or between that date and the date of bankruptcy that may be void under provisions of the Bankruptcy Act. These provisions are:
- section 120 undervalued transactions, formerly avoidance of voluntary settlements ;
 - section 121 transfers to defeat creditors, formerly fraudulent dispositions; and
 - section 122 avoidance of preferential payments.

