

ATO RECEIVABLES POLICY

PART B The Collection of Taxation Debts

Chapter 18 BANKRUPTCY ACTION

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: 24 July 2008 (This version replaces the 2006 version.)

Key legislation: *Bankruptcy Act 1966*

PURPOSE

1. This chapter deals with the factors that the Commissioner will consider before making a decision to bankrupt an individual debtor. It also sets out the Commissioner's policy in regard to voting on a debtor's proposal to have their bankruptcy annulled.

INTRODUCTION

2. Bankruptcy is the ultimate sanction for a debtor who does not pay or make acceptable arrangements to pay a debt. In bankruptcy, the debtor's property is vested in the trustee of the debtor's bankrupt estate for the benefit of creditors.
3. Individual debtors may voluntarily declare bankruptcy by filing their own petition (known as a *Debtor's Petition*) with the Official Receiver. Debtors may also become bankrupt as a result of a creditor presenting a creditor's petition in the Federal Magistrates Court or Federal Court, but this may only occur if the debtor has committed an *act of bankruptcy* within the preceding six months and owes the creditor at least \$2000.
4. Division 6 of Part IV of the *Bankruptcy Act 1966* provides a mechanism by which a bankrupt can seek to have their bankruptcy annulled. The debtor may provide creditors with a signed proposal, pledging payment of some or all of their provable debts in exchange for an earlier discharge from bankruptcy.

POLICY

5. Bankruptcy is a valid option for dealing with debtors, and the Commissioner, as creditor, will not hesitate to use this process in appropriate circumstances. However, the decision to institute bankruptcy proceedings against a debtor will not be taken lightly, and nor will it be used to 'punish' a debtor.
6. The Commissioner will not seek the sequestration of the debtor's estate where it is apparent that the debtor is solvent. However, the mere fact that a taxpayer can demonstrate a surplus of assets over liabilities will not, of itself, be

construed as proof of solvency. The Commissioner will be persuaded by clear evidence that the debtor has sufficient liquid assets to enable all debts to be paid by their respective due dates.

7. Before commencing bankruptcy action, the Commissioner will consider each case on its individual merits, having particular regard to:

(i) the financial position of the debtor:

- If there are no available assets which can be realised to satisfy the debt, bankruptcy action may not be worthwhile. Accepting payment of the debt and additional charges for late payment over a period of time may be a cheaper and more viable alternative in these cases (although it would be difficult for debtors with a history of broken promises to satisfy the Commissioner that they could or would pay over time).
- It may be unwise to agree to accept payment over time if it is likely that another creditor might initiate bankruptcy action. In these cases, should the debtor become bankrupt, any payments made during the *relation back period* may have to be repaid to the trustee in bankruptcy as a voidable preference payment.
- The Commissioner recognises that even where the debtor may appear to have no recoverable assets, bankruptcy may still be a viable form of recovery action. Assets that the debtor has transferred to or acquired in the name of other entities (such as a spouse, a company or family trust) may nevertheless be recoverable by the bankruptcy trustee.
- Bankruptcy enables the trustee to conduct an examination of the bankrupt's affairs.

(ii) the nature of the debt:

- It may be appropriate to seek bankruptcy to stop a debt from escalating rapidly. A tax debtor wishing to persuade the Tax Office to refrain from bankruptcy action would need to demonstrate that steps have been taken to stop debts from escalating.
- Some debts are a combination of disputed and undisputed debts, and bankruptcy action may still proceed even where the debt includes a significant amount of undisputed debt. The fact that a debtor has a dispute is a relevant factor to be taken into account, though it is not, in itself, sufficient to completely deter bankruptcy action. The trustee in bankruptcy can later decide whether or not to proceed with the dispute, based on their own appreciation of the debtor's case and the Commissioner will not attempt to influence the trustee's decision.

(iii) the future income of the debtor:

- If it can be shown that the debtor's financial position will improve (evidenced by financial statements and any reports which may have been obtained from an insolvency practitioner) and the debt and the additional charges for late payment can be fully satisfied at some time in the future, it

may be appropriate to consider accepting payment over a period of time. The onus would be on the debtor to demonstrate their ability to pay within that period. This option may not be appropriate for a debtor who has a history of failing to honour promises to pay.

- (iv) the risk to the revenue:
 - If it is evident or becomes apparent that the debtor is taking steps to limit their ability to pay, it may be appropriate to seek the debtor's bankruptcy as swiftly as possible.
 - (v) the cost of bankruptcy and the likely return:
 - The cost/benefit analysis of bankruptcy is an appropriate test of effectiveness, but should not stand alone as a consideration. The return from bankruptcy is not limited to any dividend from the bankruptcy; it also includes the benefit of preventing the escalation of liabilities.
 - In assessing whether to bankrupt a debtor, any last minute offers to make payments over time need to be assessed with reference to the debtor's payment history and their ability to comply with the proposed offer of payment.
 - (vi) whether special circumstances exist:
 - It may be inappropriate to take bankruptcy action in some cases (such as an elderly or handicapped debtor with limited assets).
8. In considering whether to bankrupt a debtor, the Commissioner will be alert for dispositions of property which indicate that the debtor is divesting himself or herself of assets. These dispositions would be void against the trustee under the antecedent transaction provisions if the debtor were to be declared bankrupt.
9. The Commissioner may choose to provide information about the debtor to the trustee in bankruptcy 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 bankrupt's estate. Before disclosing any information, the Tax Office decision-maker must consider the secrecy provision in the *Taxation Administration Act 1953*, and similar provisions in other Acts (such as, section 16 of the *Income Tax Assessment Act 1936*). The decision will also be guided by Chapter 2 'Accountability and review of decisions' and, if disclosure is permissible, the Tax Office decision-maker may have a discretion to disclose information to the trustee.

Proposal to annul bankruptcy

10. From time to time, the Commissioner is asked to consider a composition or scheme of arrangement proposed by a debtor seeking to have their bankruptcy annulled. While the Commissioner will naturally consider each case on its individual merits, it can generally be accepted that he will support proposals that have no adverse features and which can be expected to provide the Commonwealth with a greater proportion of the provable debt within a reasonable period than would have been forthcoming if the bankruptcy were to continue.

11. In determining whether to vote for or against such proposals, the Commissioner will have regard to all relevant matters, including, but not limited to:
 - (i) the views of the Tax Office's solicitor where those views have been sought
 - (ii) the contents of the proposal and the report prepared by the trustee
 - (iii) the adequacy of that report
 - (iv) the likelihood that the proposals put forward will be achieved
 - (v) the debtor's capacity to meet current tax liabilities as and when they fall due for the duration of the scheme of arrangement
 - (vi) other matters that are considered to be of public interest or which reasonably question the fairness and appropriateness of voting in support of the proposal, particularly where the consequence of the proposal is the removal of statutory powers of investigation, examination and 'clawback' of assets or funds, and
 - (vii) the tangible benefit to the Commonwealth revenue that is expected to be gained from the proposal.
12. The Commissioner may choose to provide information about the debtor to the trustees in bankruptcy where he believes that it is reasonably likely that the provision of such information will lead to his receiving a greater dividend from the bankrupt's estate.
13. Although the Commissioner is bound by any such composition or arrangement which is accepted by the body of creditors, the Commissioner will nevertheless seek appropriate relief through the courts if he considers that a composition or arrangement unreasonable impacts on Commonwealth revenue or contains other adverse features.

TERMS USED

Act of bankruptcy – refers to the event or circumstance which justifies a creditor petitioning the Court for an order placing the debtor into bankruptcy. Section 40 of the *Bankruptcy Act 1966* lists the many circumstances that constitute acts of bankruptcy.

Annul, annulment – means the debtor is treated as if the bankruptcy never occurred. (Note: there are special rules for tax losses where an annulment occurs.)

Composition – refers to a scheme under which the creditors agree to accept as a full and final settlement something that amounts to less than immediate payment in full, whether it be the payment of less than 100 cents in the dollar, or payment at some future time, or both.

Relation back period – refers to the period starting from the earliest act of bankruptcy and ending on the date on which the person is made bankrupt, where that act of bankruptcy occurs within six months immediately before the person is made bankrupt.

Scheme of arrangement – is a term that has a wide meaning and may include a composition, but it generally means an ordering of the bankrupt's affairs which does not necessarily entail full settlement or satisfaction. The usual object of a scheme is to avoid the immediate realisation of the bankrupt's assets and to give the bankrupt more time within which to pay creditors.

Voidable preference payment – refers to payments made to a creditor by an insolvent debtor during a prescribed period prior to the debtor’s bankruptcy which had the effect of putting that creditor into a preferential situation compared with other creditors.

Chapter 18 - Archived versions

Chapter 18: Version 4 – July 2006 (will link to chapter 18 pdf)

Chapter 19: Version 4 – July 2006 (will link to chapter 19 pdf)
