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Protecting assets from creditors - why the Tax Act is also relevant

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Generally, there is a 4 year limit on the ability of a trustee in bankruptcy to clawback assets formerly owned by a bankrupt.

There is however no time limit where the main purpose in making an asset transfer is shown to be to prevent the property from being attacked by a trustee in bankruptcy.

The decision in *McMillan v Warner (Trustee)* [2022] FCAFC 20 provides a number of insights in relation to the key rules in this area.

Broadly the factual matrix involved a decision of a husband to transfer a family home to his wife, some 16 years before committing an act of bankruptcy.

Lessons from *Cummins* case

Mr Cummins was a barrister who had not lodged tax returns for a very long time (in fact since 1955 when he was an articled clerk) and, when he was eventually identified by the ATO and lodged returns for the 1992-99 years, was then assessed by the ATO for a large amount and became bankrupt.

As a threshold issue the court in *McMillan* quoted a decision aspect of the case featuring Mr Cummins, namely *Prentice v Cummins* (2002) 124 FCR 67 and confirmed the following.

- The Bankruptcy Act confirms that clawback occurs where a transferor's main purpose in making the transfer can reasonably be inferred from all the circumstances was to defeat creditors if, at the time of the transfer, the transferor was (or was about to become) insolvent.
- If the transferor was not insolvent (or about to become insolvent) the subjective "main purpose" needs to be determined. While this concept is not defined in the legislation, it should be considered as meaning the "chief; principal; leading" or "dominant" purpose - being the concepted used in Pt IVA of the ITAA 1936. The question is assessed objectively, by reference to the objective facts and focuses on the 'ruling, prevailing or most influential' purpose (see *FCT v Spotless Services Ltd* (1996) 186 CLR 404).
- It is the trustee in bankruptcy who bears the onus of proving the main purpose of a transfer was to defeat creditors.
- The court can infer that in all the circumstances, independently of the solvency of the transferor, a transferor's main purpose was to defeat creditors.

- A transferor's main purpose may be held to have been to defeat creditors, even if at the time of the transfer the transferor has no creditors or is able to satisfy all debts.
- If a person makes a voluntary settlement immediately before entering into a "financially hazardous venture", this could establish an intention to defraud creditors, notwithstanding that there were no outstanding creditors at the time of the transfer (see, for example, *Mackay v Douglas* (1872) LR 14 Eq 106 and *Ex parte Russell*; *In re Butterworth* (1882) 19 Ch D 588).
- An inference that the main purpose of a bankrupt in making a transfer of property was to defeat creditors must be a reasonable and definite inference, not merely one of a number of conflicting inferences with equal degree of probability.

Decision in *McMillan*

The Court confirmed that (overlaying the principles from *Prentice* and *Spotless Services*) the following factors supported a conclusion that the transfer was not subject to clawback, namely:

•the husband had been advised by a supplier to his business that because there was an "absence of financial separation between your personal situation and that of the business" this was causing commercial difficulties; there was evidence that the creditor most affected by the transfer had not sought any security over the property, which supported an inference that the main purpose of the transfer was not to prevent it from becoming divisible among creditors or to hinder or delay the process of making that property available among creditors;

- the debt secured over the property at the time of the transfer was less than the value of the unsecured creditors outstanding;
- the wife did continue to provide some level of financial support to the business immediately following the transfer (although this support did diminish over time);
- further, there was no conclusive evidence that the business operations were a hazardous or speculative business venture at the time of the transfer. Nor was there any doubt as to the husband's solvency at the time of the transfer;
- the above points, combined with the significant elapse of time between the transfer and the bankruptcy meant that it was "inherently problematic" to conclude that the main purpose was to prevent the home from becoming divisible among creditors or was to hinder or delay the process of making that property available to creditors.

Conclusion - a structuring reminder

While applying the above principles to the case here, the Court confirmed that the home was not able to be clawed back by the trustee in bankruptcy, the case also highlights a key structuring issue that may have been overlooked at the time of the transfer.

In particular, as the transfer in *McMillan* was for $1 and "done out of love" it was the property that was at risk of clawback; not its value 16 years earlier.

In contrast, if the property had been transferred via vendor finance at the time and the debt then forgiven arguably it would have only been that debt at risk - and the material increase in value of the property over the 20 years between the original transfer and the Court case - would have likely been protected.