

## **The Weekend Australian**

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### **How missus saves rich and infamous By Jacquie Hayes, Samantha Hughes**

Some can live happily after going bankrupt. Jacquie Hayes reports on the rorts, and attempts to crack down on abuse

You're a high-flying entrepreneur who fears creditors might come after you if your latest venture goes bust.

Or you're a barrister who's forgotten to pay income tax for the past few decades.

Maybe you're a top surgeon who can't get professional indemnity insurance to cover you if something goes wrong on the operating table.

If you fit any of the above, you face the risk that everything you've worked for could be taken from you.

For years, such people have used so-called asset protection mechanisms such as discretionary family trusts and superannuation (both of which have tax benefits) to shield their hard-won gains.

But the past couple of years have seen growing numbers of well-to-do individuals with lots to lose take advantage of a "quirk" of law that's enabling them to warehouse lifestyle assets from creditors in the event of bankruptcy.

The structure, says insolvency expert Paul Leroy, is the result of an unintended but apparently well abused nexus between two sections of federal legislation -- the bankruptcy act and provisions within family law.

It became available after amendments to the family law act came into effect in December 2000, making operational "binding financial agreements" between couples.

Such agreements not only allow bankrupts to write off their debts, they're also able to maintain the lifestyle to which they've become accustomed by retaining effective control of assets that should be fair game for insolvency trustees, says Leroy, of Hall Chadwick Chartered Accountants.

So there's no need to say farewell to the Double Bay waterfront, the matching set of Mercedes or the holiday pad in Port Douglas. Revelations of such structures have come into focus lately in reports about the financial arrangements between such high-profile corporate failures as Jodee Rich and Rodney Adler with their wives.

Financial agreements made before or during marriage enable a couple to stipulate how their property would be split in the event of marital breakdown, says Robert Lethbridge, a family law committee member of the NSW Bar Association.

"Your primary purpose has to be to make provision for the partner, or partners, on the breakdown of the marriage," he says. "But it's effect can be that it will protect you against claims of creditors."

Once an agreement comes into effect, the assets with which it deals are off limits to insolvency trustees.

Importantly, the marriage doesn't have to actually collapse for that asset protection to apply. You really can live happily ever after.

Binding financial agreements provide for a potential breakdown, which means creditors involved in bankruptcy proceedings are stuck, Lethbridge says.

Rolling out these amendments isn't uncommon, says Steven Golledge, an insolvency specialist with The Argyle Partnership Lawyers. "You can have people living in a relationship, happily married, and one might be faced with claims that haven't yet crystallised but which everyone knows will crystallise in the future," Golledge says.

The couple can establish a binding financial agreement -- a simple, non-public, inexpensive process involving a visit to a lawyer and costing about \$300 -- and continue to live happily together.

"Then, come the day of reckoning, it gets whipped out of the top drawer, and this agreement now comes into effect."

Ordinarily, when someone is made bankrupt, they have to disclose to their trustee all assets held at the time of being made insolvent. These can be sold to pay outstanding debts.

Further, any assets they get once they've been made bankrupt also become the property of the trustee, including an inheritance, shares and business assets. Superannuation is untouchable.

Once a person is declared bankrupt, they're released from their debts. Creditors can't recover money from a person in bankruptcy. Instead, they must lodge claims with the trustee.

A secured creditor -- like a bank that has provided a mortgage -- can repossess and sell the property it financed to recoup its money.

But it is when the assets are held in names other than that of the bankrupt that insolvency trustees are tested.

George Lopez, an insolvency expert and partner at Perth-based accountancy firm Melsom Robson, says there are three conditions under which a trustee can "attack" assets that have been transferred to someone else.

The first is where the transaction is deemed to have been "uncommercial" -- say, where a property has been given to a spouse or another party for less than market value. Trustees can take the asset if the transfer happened within five years of the bankruptcy, depending on conditions.

The second exists where trustees identify an intent to defraud creditors.

An example is where someone knows they're about to receive a bankruptcy notice, and transfers assets to other parties to prevent them being taken away in anticipated legal action.

This is the one condition that can unwind even binding financial agreements.

But assets divested in this way, regardless of how recently or long ago the shift took place, may be difficult to recover, Lopez says, because trustees must prove the transfers were done with fraudulent intent.

But it can happen -- as bankrupt barrister John Cummins recently found (see box on previous page). The third case in which trustees can recover assets is when a bankrupt is found to have paid one creditor in preference to another, an arrangement that often benefits a relative or friend.

The federal Government has been aware of the improper use of the provisions for some time.

Early last year, the Attorney-General's Department set up a task force with the Insolvency and Trustee Service Australia to investigate ways to stamp it out.

But those working in the field warn that practicalities may override any legislative change, regardless of how effective it may seem.

**Golledge** says there's not a lot wrong with the law as it stands. The problem is more one of practice than theory. "Transfers occur and, in the real world, to attack them takes significant resources, energy and effort," he says. "Nine times out of 10, neither the trustee nor the creditors will have the will or the resources to pursue the claims they might have under the Bankruptcy Act or the general law."

For this reason, **Golledge** says there's likely to be even more improper use of the provisions in future. "It's such a common strategy because, in practical terms, most (agreements) won't be scrutinised or attacked," he says. "Obviously the higher profile ones will be, because the potential benefit to creditors is large if millions of dollars of assets are transferred out. But with a smaller bankruptcy, it becomes a very marginal proposition."

There are other forms of asset protection, says **estate planning expert Peter Bobbin, of the Argyle Partnership Lawyers**.

The cornerstones are testamentary trusts, family discretionary trusts, superannuation and life assurance policies, he says.

Of the last two, the combined worth is protected up to the pension RBL, which for this financial year is just over \$1.1 million.

Not only is super safe while in the accumulation phase, if you cash it in during your bankruptcy -- a point at which any financial gains generally become fair game for creditors -- the cash is protected, and so is whatever you buy with it, **Bobbin** says.

Having assets held by a non-exposed partner or spouse is the final protection cornerstone, but there are risks.

We may joke about the prospect of that person making off with the booty.

But it does happen. If an asset-rich spouse does indeed run away, **Bobbin** says the family court will act to return to the duped partner the portion of the assets determined to be rightfully theirs.

But as Lethbridge points out on the use of binding financial agreements: "If you make substantial transfers in favour of a spouse and the marriage does actually break down later on, you can't say, 'Whoops, I only did that because I was worried about the creditors'."

You may also have a problem, says **Bobbin**, if you return home one day to find a postcard from Brazil or some other non-extradition country. "Similarly, if the family home is in the spouse's name and all of a sudden you find that it's mortgaged to 110 per cent and she's bolted, that's a big problem," he says.

Five reasons to avoid going broke

- \* Ability to borrow or purchase items on credit are limited. A person's name is held on the commercial credit reference record for seven years even if the bankruptcy has been discharged
- \* The bankrupt's assets, including the family home, become the property of the bankruptcy trustee, who can sell them to pay creditors
- \* It can hurt future job prospects (for example, former bankrupts may not be able to be employed in securities)
- \* A bankrupt isn't allowed to travel overseas without the trustee's permission
- \* Undischarged bankrupt can't be the trustee (or, therefore, a member) of a self-managed superannuation fund

Source: RetireInvest

EARLIER this month, bankrupt barrister John Cummins was found by the federal court to have transferred assets to his wife and family trust to avoid claims for unpaid tax.

Cummins was stripped of his appointment as a Queen's Counsel, and struck off the roll of barristers after it was found he hadn't paid tax for 45 years.

He was made bankrupt on his own petition in December 2000, owing almost \$1 million in tax. The trustees of his estate are trying to recover property and funds they claim he transferred to his wife Mary in 1987.

Among the transfers were a half-share in the family's Sydney home of \$205,250, and the transfer to the Cummins Family Trust of shares in his chambers of \$360,000. The Hunter's Hill family home was recently sold for \$2.2 million.

The court ruled that, at the time of the transfers, Cummins was aware of his outstanding tax obligations and transferred his assets to increase the chances of protecting them from creditors, specifically the tax commissioner.

On Wednesday, Mrs Cummins agreed to transfer half the proceeds of the family's home into an account, pending the outcome of the recovery action. The case is expected to return to court on December 19.

HAVING sold her \$12 million mansion in Sydney's exclusive Point Piper last year, Lyndi Adler is now said to be on the hunt for another home in Sydney's eastern suburbs.

For a woman without a paid job, Rodney Adler's wife appears to be doing well for herself. The financial arrangement between Adler and his wife came to light after the \$5.3 billion collapse of insurance giant HIH.

Mr Adler, who two years ago was estimated by BRW's Rich List to be worth \$80 million, said at the time he avoided holding assets in his name.

Mrs Adler bought the Point Piper mansion, a former convent, in 1999, before HIH's collapse in March 2000.

Now banned from acting as a company director, Mr Adler has been ordered to pay \$9 million in fines and compensation after a court found he breached his duties as a director relating to an HIH-associated trust.

Before this ruling, the Australian Securities and Investments Commission successfully obtained a freeze order on his and his wife's assets.

The litigation isn't over yet for the former One.Tel and HIH director. He may face further financial penalties if any adverse findings are made against him. Getting access to Mrs Adler's assets would be difficult unless a link to the collapse of the companies could be established.

Jodee Rich and his wife Maxine have made use of the relatively new Binding Financial Agreement under the Family Law Act. The agreement effectively stipulates how their assets would be divided in the event of a divorce.

It was entered into just a month after One.Tel was placed into administration in May last year, leaving shareholders and creditors almost \$2 billion out of pocket.

Under the deal, Rich transferred most of his assets, including his half-share of the family's \$6 million Vaucluse home, a \$4 million holiday home in north Queensland, boats, cars, art, furniture and cash to his corporate lawyer wife.

At the time, Rich's lawyer told ASIC that the transfer had been executed to "provide for his wife and children, given that Rich's financial future is under a cloud and that Mrs Rich's career as a lawyer and a public company director may be compromised by these events".

Shortly after the agreement became public knowledge, ASIC obtained a freeze on the couple's assets. In December last year, these orders were extended, precluding the couple from moving assets, transferred under the Family Court Act, outside Australia without 14 days' notice to ASIC.

But the freeze, says ASIC, does not override the Family Court agreement.

Samantha Hughes

This case study demonstrates how a couple can make use of legitimate provisions within the Family Law Act to protect assets from "attack" by creditors in the event of bankruptcy.

It considers the circumstances over a four-year period of Charles and Simone Whyte. He's an entrepreneur who runs a property development company. Simone has 50 per cent of the shares in the company but is not a director. The Whytes jointly own the matrimonial home, which is worth \$800,000. They have three children who go to private school.

From year one, Charles' company is highly geared but successive project re-financing during a period of increasing property values has generated substantial funds for the company. The company owes large sums to subcontractors, suppliers and financiers, debts for which Charles has given personal guarantees.

In year two, Charles starts to believe the property boom may soon end. The company's credit funds are paid into his personal superannuation fund and family trust. Charles and Simone visit their lawyer and get a binding financial agreement which transfers Charles' interest in the matrimonial home to Simone. The couple transfer their company shares to the family trust.

In the third year, the Whyte's assets are held as depicted in the accompanying graphic.

In year four, Charles' company defaults on loans and other debts, and goes into liquidation.

Charles is pursued under personal guarantees and declares himself bankrupt. He resigns as company director and is replaced by Simone.

Charles in turn is employed as a “project manager” on a salary of \$50,000 per annum, too low to become accessible by insolvency trustees.

The result of the structure is:

- Charles has no interest in the matrimonial home
- Charles’ annual income contribution to creditors is nil
- The family trust continues to meet lifestyle expenses including school fees, family holidays and motor vehicle costs
- The development company is liquidated for failure to pay subcontractors. It does not pay any dividend to creditors

Source: The Argyle Partnership Lawyers