



## **BANKRUPT BARRISTER “BEGGARS BELIEF” BUT BEATS BANKRUPTCY TRUSTEES**

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*‘He had the prosperous look of a lawyer.’*  
(W. Somerset Maugham (1874 – 1956) “A Writers Notebook” 1917)

The wealth of lawyers is the substance of jokes around the world. However a Full Federal Court of Australia has found no evidence that a barrister in practice for more than 22 years was in receipt of an income that would give rise to an obligation to pay income tax. This is the stark conclusion to be drawn from the case of *Cummins v The Trustees of the property of John Daniel Cummins, a Bankrupt* [2004] FCAFC 191 (30 July 2004). As a result, the fact that the barrister had omitted to lodge tax returns for 45 years, could not be used to infer that he may have had a debt to the Tax Commissioner. In this way, the bankrupt’s wife and family trust were able to overturn a trial judge’s decision that transfers of the bankrupt’s property to them had been for the purpose of defeating the bankrupt’s creditors. This case is a salutary lesson on both the evidence required to challenge the transfer of assets by those who subsequently become bankrupt, and also on the difficulties facing bankruptcy trustees as they endeavour to recover assets for the benefit of creditors.

### **Background**

An abbreviated timetable of the facts in this case is as follows:

<b>Date</b>	<b>Event</b>
1957	Admitted as a solicitor.
28 April 1961	Admitted to the Bar.
11 December 1964	Married Mary Cummins.
27 July 1970	Purchase of property at Hunters Hill for \$31,000, as joint tenants.
2 December 1980	Appointed Queens Counsel.
9 May 1986	Supreme Court of Victoria delivers judgement at first instance in <i>Giannarelli v Wraith</i> holding that barristers were no longer immune from liability in respect of a claim of negligence against them.
19 May 1987	Full Court of the Supreme Court of Victoria in the <i>Giannarelli</i> proceedings held that a barrister was still immune from suit in relation to work carried out in Court and that the decision at first instance in that case was incorrect.

Date	Event
10 August 1987	Bankrupt establishes the “Cummins Family Trust” beneficiaries of which are Mrs Cummins and their four children. Trustee is a shelf company and bankrupt and Mrs Cummins own one share each.
	Bankrupt instructs his solicitor to prepare documentation for the transfer of his assets.
14 August 1987	In the <i>Giannarelli</i> proceedings an application to the High Court for Special Leave to Appeal from the Full Court decision was granted.
26 August 1987	Bankrupt transfers half interest in property at Hunters Hill to his wife for a stated consideration of \$205,520 (Court finds that no payment was actually made).
	Bankrupt transfers shares in Chambers to the Trust for a stated consideration of \$360,000.
25 July 2000	Deputy Commissioner of Taxation issues a Statement of Claim for \$955,672.92.
13 December 2000	Bankrupt files a Debtors Petition.

The trustees in bankruptcy sought to recover from the Trust and Mrs Cummins, the assets transferred to them in 1987, namely the ½ interest in the Hunters Hill property and the interest in the bankrupt’s barristers chambers.

### Trial Judge

It is necessary to consider the trial judge’s decision in some detail. This is because on appeal, the Full Federal Court considered exactly the same evidence. However the majority reached the opposite conclusions to Sackville J.

At first instance (*Prentice & Anor v Cummins & Ors* [2002] FCA 1503) the trustees were successful. Sackville J found that although “the evidence adduced by the Trustees in some respects is somewhat sparse” (at [37]) this did not prevent the Trial Judge from drawing inferences adverse to the bankrupt. The transactions were challenged by the bankruptcy trustees under section 121 of the Bankruptcy Act. This section provides:

- “(1) A transfer of property by a person who later becomes a bankrupt (the “**Transferor**”) to another person (the “**Transferee**”) is void against the trustee in the Transferor’s bankruptcy if:
- (a) the property would probably have become part of the Transferor’s estate or would probably have been available to creditors if the property had not been transferred; and
  - (b) 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.”

Section 121(2) provides that the trustee may demonstrate the Transferor's main purpose by leading evidence from which a Court could reasonably infer that the bankrupt was about to become insolvent. This sub-section was not relied upon by the trustees in Mr Cummins case other than a belated application which was refused by the Court. Although no reasons were given by the trustees, it is likely that the absence of tax returns or unpaid creditors from 1987 meant that it was difficult for the trustees to demonstrate the insolvency of Mr Cummins at the time. The simple fact is that his creditors at the time had (with the exception of the Tax Commissioner) all been paid, or at least there was no evidence to the contrary.

#### Trial Judge's Reasoning

The context of the judgment is significant. At the end of the case presented by the bankruptcy trustees, the bankrupt's wife and family trust ("the Transferees") made a 'no case submission'. That is, they asked the Court to find that the trustees had failed to prove the matters necessary to allow their case to succeed, even before any defence was considered. The trial judge allowed this application to proceed, but only on the basis that the defendants could not lead any evidence, if the application was unsuccessful.

The trial judge looked at three issues in deciding whether the trustees had done enough to prove that the transactions were void under section 121:

1. Was there evidence that the Tax Commissioner was a creditor? Under this heading his Honour looked at:
  - (a) Inferences from the bankrupt's profession as a barrister.
  - (b) Inferences from the acquisition of assets by the barrister.
  - (c) Inferences from later tax returns ultimately lodged by the bankrupt.
2. Was there evidence that the bankrupt did not have assets to pay any tax liability?
3. Was there evidence as to the main intention of the bankrupt? Here his Honour looked at:
  - (a) Notes from the solicitor who performed the transfers.
  - (b) Events surrounding the *Giannarelli v Wraith* litigation

#### **Issue 1: Was the Tax Commissioner a Creditor?**

The Trial Judge found that the bankrupt had not lodged any tax returns for 45 years, between about 1955 and 14 February 2000, when he lodged tax returns for the 1992 to 1999 taxation years (at [41]). In the absence of these tax returns, it was difficult for the trustee to produce evidence of the income earned by the bankrupt during this period. There was therefore nothing to demonstrate that the bankrupt had a liability to pay tax to the Commissioner at that time.

His Honour was left to see what inferences could be drawn about the bankrupt's liability to pay tax.

He found three:

- (a) inferences from the bankrupt's practise as a barrister.

The trial judge, unsurprisingly, found it had to believe that a barrister in practice for such a long period, without lodging any tax returns, would not have a tax problem.

“It seems to me that there is one overriding factor in this case that cannot be pushed into the background or minimised. It is that by August 1987 the Bankrupt had not lodged a tax return for over 30 years. By that time he had been in practice as a barrister at least 22 years and probably 26 years..... The Bankrupt, as at 1987, had what properly can be described as “an impending liability” for income tax. ....The Bankrupt who, after all, was a lawyer, must have known and appreciated in 1987 that the ATO’s state of ignorance could end at any moment.” (at [122])

The Court found that the Bankrupt must also have been aware that his failure to lodge tax returns constituted a criminal offence and that once discovered, he was at risk of “professional disgrace and loss of his right to practise as a barrister” (at [123]). Moreover, the Bankrupt plainly had no intention of “coming clean” in 1987 since no tax returns were lodged, ultimately, until 2000.

Based on these facts the Court inferred that Mr Cummins was:

“Prepared to take measures which he well understood were designed to prevent that Commissioner recovering tax due.... in respect of past taxation years.” (at [123])

Therefore, according to the Trial Judge, the:

“Irresistible inference from the evidence is that, .... he was fully aware of the fact that with each passing year his liability to the Commissioner was increasing.” (at [124])

As though struggling to comprehend it, Sackville J started repeating himself:

“By 1987, the Bankrupt had been in practice as a barrister for at least 22 years and probably more. He had been appointed a senior counsel in 1981, six years before the asset transfers took place. .... [I can]take judicial notice of the fact that appointment as a senior counsel is and was at the time a recognition of a barrister’s professional attainments and expertise.” (at [126])

- (b) inferences from the bankrupt’s acquisition of assets.

The trial judge also found that the bankrupt’s acquisition (at some time) of barrister’s chambers in the City and at Parramatta meant he must have had a taxable income.

“There is nothing to indicate that the assets connected with his practice were paid for otherwise than out of the Bankrupt’s professional earnings. These facts lead readily enough, in my opinion, to an inference that for many years prior to 1987 the Bankrupt derived substantial assessable income from his practice as a barrister and, after taking into account allowable deductions, would have been liable to pay tax on that income.”  
(*Ibid*)

- (c) inferences from the Tax Returns lodged in 2000

Finally, on this point, his Honour then went on to refer to the tax returns which the bankrupt had ultimately lodged, for the 1992 to 1999 taxation years. Those returns, which had been lodged in 2000, indicated that the bankrupt had earned an average \$337,420 for the first four years in gross receipts. Accordingly to his Honour, this information “allayed” any doubts that he had about the appropriateness of drawing the inferences that the bankrupt was in receipt of a substantial income (and subject to a substantial tax liability) from his practice as a barrister.

In conclusion, therefore, his Honour was prepared to draw the inference:

“In 1987 the Bankrupt faced very substantial tax liabilities flowing from his tax default over many years.”

His Honour would not quantify this figure, but was prepared to find that it amounted at the very least to several hundred thousand dollars.

### **Issue 2: Was there evidence the bankrupt had no assets to pay his liabilities?**

The next issue his Honour was forced to deal with was the lack of evidence of the Bankrupt’s assets and indeed whether or not these were sufficient to pay any tax liability the Bankrupt might have had. Once again the absence of evidence allowed the bankrupt’s wife and family trust to assert that the trustees had failed to make a case for them to answer.

In response, Sackville J found that:

“There is no evidence that, after executing the transfers in 1987, the Bankrupt retained assets substantial enough to enable him to satisfy his liability to pay tax.” (at [131])

This of itself would not have been enough, however his Honour was prepared to look at the following additional matters to draw the necessary inference:

- If (as his wife contended) one of the bankrupt’s motives was to protect himself from being sued by future clients, it would be illogical to retain any substantial assets in his own name.
- If anything about the case was clear (his Honour found) it was that the Bankrupt was not concerned to make provision for his income tax liabilities.
- The tax returns which had been lodged gave no indication of the disposal of any substantial assets during the 1992 to 2000 years.
- The bankrupt’s statement of affairs lodged in 2001 disclosed no substantial assets.
- The bankrupt’s wife had asserted to a bank, in 1998, that all assets were in her name.

### **Issue 3: The Bankrupt’s Intention**

The third issue was whether the trustees had proven that it was the bankrupt’s main intention to defeat or delay his creditors. In the circumstances, this meant the Tax Office. Here there was at least some useful evidence, in notes taken by the bankrupt’s solicitor, and public knowledge of the *Giannarelli* litigation.

#### **(a) Notes taken by the bankrupt’s solicitor**

The Trial Judge was able to refer to some helpful notes made by the bankrupt’s solicitor. These file notes included references to the possible application of section 121 of the *Bankruptcy Act* and also section 37A of the *Conveyancing Act 1919* (NSW). This latter section relates to transactions made with the intent of defrauding creditors. There were other helpful references within these file notes including that “Mary [Mrs Cummins] *must* be a *purchaser*”; and also raising squarely the issue “where is evidence of intent”?

The bankrupt suggested the notes were merely a “prudent solicitor” considering the possible application of the *Bankruptcy Act* and that there was nothing to suggest the awareness, on the part of the solicitor, of any purpose of the bankrupt that might involve defeating his creditors.

Sackville J agreed that the file notes did not indicate that the solicitor was aware of Mr Cummins' tax liability. However, his Honour was prepared to find that it was very likely that the solicitor had discussed his views (regarding the effect of section 120 and 121 of the *Bankruptcy Act*) with Mr Cummins. Given that Mr Cummins "had no intention of "coming clean"", his Honour was satisfied he should infer that:

"The principal or leading purpose of the transfers was to protect his major assets from any claims that would be made by the Commissioner if and when the tax delinquency was discovered."

(b) *Giannarelli v Wraith*

In arguing the trustee had failed to make out their case, the bankrupt pointed to three other possible purposes which (so it was submitted) were consistent with the evidence as possible explanations for the bankrupt's transfer of assets in 1987 (at [70]):

1. a desire to provide for his wife and family;
2. a desire to save a marriage that might otherwise have been in difficulties;
3. the contemplation, arising out of the *Giannarelli v Wraith* case, that the High Court might find there was no basis for barristers immunity from suit and that the bankrupt might therefore be at risk from some future dissatisfied client.

His Honour thought there might be some merit in this argument. However compared with the inevitability that he would one day be pursued for his tax liabilities, Sackville J found that:

"It defies reality to conclude that the Bankrupt's main purpose was other than to defeat the Commissioner's claims, which could be kept at bay only so long as the Bankrupt's tax delinquency remained undetected." (at [146])

Accordingly, the trial judge found the trustees had made out their case. The transfer of the bankrupt's half interest in the Hunters Hill property, and the shares in his barristers chambers, were subsequently found to be void as against the trustees in bankruptcy.

## Appeal

On appeal, the decision by the Transferees to make a "no case submission" proved a master stroke. This was because, in the absence of oral testimony given by the bankrupt or his wife, the Full Federal Court was able to find that:

"We are in as good a position as the primary judge to draw any inferences that have to be drawn, because the Respondents' case ..... was entirely documentary. In those circumstances, the primary judge had no advantage over this Court." (at [87])

Therefore, by avoiding any findings regarding credit, or based upon the demeanour of the witnesses in the course of giving their evidence at first instance, the bankrupt's wife and family trust were able to ask the Full Federal Court to draw completely different inferences to the Trial Judge at first instance.

And they did.

By a majority of 2 to 1 the Full Federal Court upheld the appeal of the bankrupt's wife and family trust.

### Issue 1: Was the Tax Commissioner a Creditor?

The majority of the Full Federal Court had great difficulty with the lack of evidence presented by the trustees in bankruptcy. That is:

1. There was “no evidence that during the years before 1987 ... the bankrupt’s taxable income was at a level which gave rise to an obligation to pay tax.” (at [90])
2. Therefore, “the evidence did not establish that, on a balance of probabilities, the bankrupt had a contingent liability to the Commissioner for any tax, let alone several hundred thousands of dollars.” (at [91])
  - (a) Inferences from the bankrupt’s profession as a barrister.

Sackville J relied upon the fact that the bankrupt was a barrister in practice for many years, and had been appointed a senior counsel. However the majority held this of itself did not allow the Trial Judge to make an assumption “about even the approximate level of the bankrupt’s taxable income.” (at [100])

It is interesting to note the fundamentally different approach of the trial judge and dissenting judge, Justice Tamberlin, with the majority, on this point. For the latter there was no document that could be produced, and (in the absence of oral evidence from the bankrupt) no admission, concession or statement that they could rely upon, as evidence of income earned by the bankrupt giving rise to a liability to pay tax. For the former, it was a matter of common sense – an “irresistible inference”; and to suggest otherwise “defies reality” and “beggars belief”.

- (b) Inferences from the bankrupt’s acquisition of assets

Although they would have accepted a small amount of evidence that the bankrupt’s barristers chambers had been paid for out of his income, the majority found “there was no evidence that these assets had been paid for out of the bankrupt’s professional earnings.” (at [92]) In fact “there was simply no evidence about the source of funds for this acquisition” at all.

In essence, in looking at the **lack** of evidence that the bankrupt’s barristers chambers had been acquired **otherwise** than from his income, the Trial Judge had reversed the onus of proof and committed an error of law.

- (c) Inferences from the tax returns lodged in 2000

Justices Carr and Lander did not think that it was open to the trial judge, where the evidence fell short

“to allay any doubts (which presumably he had) by extrapolating backwards for a period of between four and eleven years as the basis for justifying an inference that in 1987 the bankrupt faced contingent tax liabilities” (at [103]).

### Issue 2: Was there evidence the bankrupt had no assets to pay his liabilities?

Similarly, in finding that there was no evidence of assets with which the bankrupt could pay any tax liability, the majority also found that Sackville J had reversed the onus of proof. It was for the bankruptcy trustees to demonstrate that the bankrupt had deprived himself of assets (so as to defeat creditors) and not the other way round. In short:

“There was simply no evidence to show that, by the transfers, the bankrupt had denuded himself of assets sufficient to pay his supposed liability to pay tax.” (at [108])

### Issue 3: The bankrupt's intention

(a) Notes taken by the bankrupt's solicitor

As regards the advice received from his solicitor, the majority found that the solicitor's file (at [119]) "disclosed only private file notes and no advice to the bankrupt at all on the question of avoiding liabilities. It included a contemporaneous letter from the bankrupt containing instructions to make a gift" of the bankrupt's Parramatta chambers (which did not proceed).

In a somewhat surprising statement, the majority held that because his pattern of not filing income tax returns continued for another 12 years, there was nothing in the evidence to suggest that in 1987 the bankrupt "anticipated being unmasked as a person who had not filed income tax years for many, many years." (at [121])

(b) *Giannarelli v Wraith*

Finally, the majority of the Full Federal Court held that the only significant event which occurred in 1987 was the *Giannarelli* litigation (at [122]). Therefore it was much more likely that the transactions which occurred during that year were as a result, or with the purpose of, responding to that litigation, than to defeat creditors. Even though it was true that the bankrupt had instructed his solicitor before the High Court granted special leave nevertheless:

"The application for special leave must have been made shortly after 19 May 1987, or, more likely, shortly after 10 April 1987. Mr Harris received his instructions from the bankrupt no later than 10 August 1987 ..... The approximate coincidence of the timing is, in our opinion, quite marked. .... The litigation was very well known in legal circles at that time."

Accordingly their Honours were quite prepared to find that the evidence before the Trial Judge "did not permit the principal inference..... that the bankrupt's purpose in transferring the Hunters Hill property to Mrs Cummins and the Shares to the Second Appellant was to defeat or delay creditors."

### Dissenting Judge

Justice Tamberlin dissented from the majority of Carr and Lander JJ, and found:

"It **beggars belief** to suggest that by August 1987, after spending over twenty-two years in practice at the New South Wales Bar, six of which as Queens Counsel, without paying any tax, Cummins had not built up a substantial liability for unpaid tax and the attendant penalties and interest consequent upon such defaults, or that he was not fully conscious of his exposure to the Commissioner when the August 1987 transfers were implemented." (at [237] emphasis added)

His Honour found that it would have been "most unusual to take the significant decision to commit to a divesting of major assets before the decision of the High Court on a special leave application, when that decision may have brought an end to the question of barristers in-Court immunity by refusal of leave." (at [218]) His Honour therefore found that the *Giannarelli* litigation merely:

"Focussed the attention of Cummins on the need to protect his asses from pursuit by the Commissioner in the light of his decisions over the preceding forty-five years not to lodge any tax returns." (*Ibid*)

His Honour also placed much greater weight on the notes taken by the solicitor when receiving instructions from Mr Cummins. Tamberlin J was prepared to find that:

“The solicitor’s notes can be taken to have resulted from, and summarised legal issues arising from, discussions between Cummins and his solicitor in 1987 prior to the transfers.” (at [242])

The evidence from the solicitor’s notes and a subsequent letter written by the solicitor went “To support the inference that Cummins wished to place his major assets beyond the reach of his creditors” (at [244]).

### **Conclusion**

The lack of evidence led by the bankruptcy trustees is on one view surprising. The failure of the bankruptcy trustees in this regard was the subject of criticism by both the Trial Judge and the Full Court. Both made rather helpful suggestions as to the type of evidence that the bankruptcy trustees might have led (Sackville J at [120] and the majority of the Full Federal Court at [105]). These suggestions included issuing subpoenas to the barrister’s instructing solicitors, his clerk, or indeed to the bankrupt himself. Either from the evidence produced as a result of these subpoena, or from inferences drawn from the lack of evidence produced in response to these subpoena, the Trial Judge and Appeals Court thought there might have been evidence of a taxable income on the part of the bankrupt.

Even if this was the case in this particular instance, the case demonstrates the inherent difficulty faced by a bankruptcy trustee conducting a section 121 case. A bankrupt can rely upon his own failure to maintain proper books and records in order to deprive the bankruptcy trustee of the information required to prove his case. One wonders what would have happened if the documents which evidenced the bankrupt’s income had been destroyed in a fire lit by the bankrupt. Section 121 is a powerful weapon given to a bankruptcy trustee to challenge transactions that occurred (in this case) many years before the date of bankruptcy. Its usefulness is severely circumscribed in the absence of sufficient documents evidencing the bankrupt’s creditors and intentions at the time of the transfer. An unscrupulous (or perhaps merely careful) debtor can take advantage of these difficulties to make a challenge to asset transfers very difficult.

The recent withdrawal of proposed amendments to the *Bankruptcy Act* which would, in effect, reverse the onus of proof regarding certain transfers of assets is not entirely coincidental. The legislation arose out of a joint task force investigating perceived “abuses” of the *Bankruptcy* and *Family Law Acts* by persons (including high profile barristers) to avoid meeting their tax obligations.

The Government has promised that notwithstanding the failure of this first attempt to fix the problem, a further draft will be forthcoming. Its scope, and effectiveness remain to be seen.