Risky business puts asset transfers in the spotlight

Business owners whose business is marginal or risky need to be aware of the long reach of the Bankruptcy Act in being able to recover assets transferred to other parties, a leading group of accountants and lawyers have been told.

Barristers Stewart Maiden QC and Scott Morris told a Pitcher Partners legal briefing that recent cases had illustrated the ability of section 121 of the Bankruptcy Act to unpick asset transfers, even where "assets were sheltered during safer or happier times".

Mr Morris gave the example of a Melbourne car dealer made bankrupt in 2014, after his fifty-year family business entered into substantial new financial commitments.

The bankrupt had become a partner of his brother and father in the business in 2002.

To manage the market competition, the business took on significant loans in 2003 and 2004 and, a year later, the bankrupt transferred his interest in a Brighton property to his wife at a time when he was also guaranteeing significant liabilities.

The car dealership did not collapse until 2014 and the transferor did not become bankrupt until 2014, the bankruptcy trustee was able to gain access to the bankrupt's interest in the Brighton property.

Mr Morris said the case was important as it highlighted the scope of Section 121, and the risk to people operating what the law called "hazardous" businesses with a high degree of risk or volatility — even if facilities are not in default and creditors are not knocking at the door at the time the asset transfer takes place.

"If you are going into business, even if you are not taking on very substantial liabilities, if you are considering risk or are motivated to avoid risk by transferring your property, that puts the transferor at some risk," he said.

Defining what makes a business a hazardous venture was difficult, however, though Mr Morris suggested it could be judged by the likelihood of a given risk and the seriousness of that risk's impact, rather than a particular business sector or revenue profile.

"If the business risk is enough to motivate someone to transfer assets out, it might be a benign business, however you could meet the requirements of the section," he said.

Mr Maiden said the scope of Section 121 also posed risks for people starting out their professional lives who thought it prudent to transfer property to a trust or a spouse for asset protection.

"It comes as a surprise to most people to learn that a person with no immediate creditors could down the track face having an asset being clawed back when there was no trouble when it was transferred," he said.

“However, under Section 121, it might not matter if a transfer occurred long before there was any prospect of bankruptcy,” he said.

Nor might it matter that the person had no creditors at all at the time.

“If the court is later convinced that the asset was removed for the main purpose of preventing potential creditors from obtaining the asset, then Section 121 can be invoked, notwithstanding the fact there were no pressing creditors at the time of the transaction,” he said.

For people looking to structure their affairs, the reach of Section 121 could put a dampener on asset protection, however Mr Maiden said there were some ways to mitigate the risk that an asset transfer would be challenged.

“In some cases, but not all, the longer that passes between an asset being transferred and the events that result in bankruptcy, the harder it is going to be for the trustee,” he said.

“If you do your structuring at the start of an enterprise, and the enterprise is properly managed, that’s going to reduce the chance it will be subject to attack by a trustee.

“There are no guarantees, but you can minimise your chances by being proactive from the outset.”

“The best option would be to generate assets within a trust or structure rather than generating them in one’s own name and transferring them at a later time,” he said.

“There is a significant difference, sometimes an earth-shattering difference, between an arrangement whereby an asset is transferred from a person who later becomes bankrupt to another entity, and an arrangement whereby an asset originates in another entity.

The second is almost unimpeachable save to the extent that the bankrupt has contributed to it over time directly.”