



Précis Paper

Bankruptcy and Family Law : Clash or Harmonisation?

A discussion of bankruptcy in family law proceedings, in matters involving formerly married or de facto partners.

Discussion Includes

- Insolvency law and family law
- Bankruptcy statistics
- The interaction of family law and insolvency law
- Bankruptcy legislation in family law
- Recent amendments to the Family Law Act
- Bankruptcy and property settlements under the Family Law Act
- Commissioner of Taxation v Tomaras [2018] HCA 62
- Costs
- When both parties become bankrupt
- Conclusion

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Bankruptcy and Family Law: Clash or Harmonisation?

1. In this edition of BenchTV, Irina Hoskinson (Barrister, 3 St. James Hall Chambers) and Lee-Ann Walsh (Barrister, Frederick Jordan Chambers) discuss bankruptcy in family law proceedings.

Insolvency law and family law

2. Bankruptcy in this presentation refers to the event of personal insolvency, when an individual is not able to pay his or her debts when they fall due, and the status of that person after they are declared bankrupt by the court or by the Official Trustee in Bankruptcy.
3. The Family Law matters under discussion are the financial or property disputes between former married couples or de facto partners.

Bankruptcy statistics

4. The Australian Financial Security Authority website tells us that there were 16,811 new bankruptcies in Australia in 2017–18, an increase of 3.0% from 2016–17. The annual rise in bankruptcies is the largest since 2008–09. Despite this rise, the number of bankruptcies is below 2008–09, when there were 27,520 bankruptcies. Bankruptcies in NSW also rose by 3% in 2017-2018.
5. In NSW there were 4,604 bankruptcies in the last financial year. While the total NSW population at the end of June 2018 quarter was recorded by Australian Bureau of Statistics to be 7.98 million. Bankruptcies are not a very frequent occurrence, however they raise a lot of legal issues and occupy a lot of the courts time.

The interaction of family law and insolvency law

6. It is not uncommon, when one of the parties to the marriage becomes bankrupt, that marriage discord ensues. When a person becomes bankrupt, their estate gets sequestrated and a Trustee in bankruptcy is appointed. Therefore, when their marriage or de facto relationship ends, that trustee has a potential interest in the matrimonial assets, on behalf of the bankrupt spouse' creditors. So, the phrase "there were three of us in that marriage" takes on a new meaning in the context of bankruptcy.

7. Depending on the matter, sometimes the Trustee has to join the parties' Family Law proceedings in order to have its position considered in any decision the Court makes in relation to the matrimonial assets.
8. Unfortunately, the legislation governing bankruptcy in this context is anything but straightforward. Bankruptcy laws are well developed and are being implemented by Federal Courts. The main Act governing the powers and responsibilities of trustees and the behaviour of bankrupts is the *Bankruptcy Act 1966 (Cth)*. It is a Federal Act and applies everywhere in Australia. The *Bankruptcy Act* is silent on the situations where the bankrupt person is going through the separation of the family, apart from the two sections addressing the Family Court's jurisdiction:
 - *Section 35* Where a party to a marriage is bankrupt and the trustee of the bankrupt estate is a party to proceedings for property settlement, section 79A or spousal maintenance proceedings;
 - *Section 35A* Where bankruptcy proceedings are pending in the Federal Court or the Federal Circuit Court those courts may transfer the proceedings to the Family Court. In the case of the Federal Court, the parties' consent is required.
9. As one would expect, a significant part of the *Bankruptcy Act* is dedicated to dealing with the bankrupt's property, and the rules as to how to recover same from third parties. Of interest to the current discussion are ss 120 and 121 of the *Bankruptcy Act*.
10. Those sections are dealing with transfers of the bankrupt's property before the bankruptcy took place. They give the Trustee power to claim, or "claw back" the unfair transfers, so that the property could be divided equally amongst all the creditors.
11. The jurisdiction to deal with these kinds of claims is vested in the Federal Court.

Bankruptcy legislation in family law

12. Family law matters are governed by the *Family Law Act 1975 (Cth)*. It is also a Federal Act. In relation to the property settlements, ss 79, 79A (and their counterparts governing the de facto relationships) apply.

Recent amendments to the Family Law Act

13. The *Family Law Act* was amended a number of times, and for present purposes, a couple of significant amendments should be mentioned.
14. *Part VIIIAA* was introduced in 2003 and took effect on 17 December 2004. The provisions of the part broadened the Family Court's power to bind third parties to a marriage. *S 90AE* states that the Court may make an order under s 79 (alteration of property interests) binding a third party. That includes binding the parties' creditors. *S 79(10A)*

has the effect that the creditor's rights are subsumed by the trustee. Therefore, one assumes that s 90AE applies to the trustee in bankruptcy, although the legislation could have been better drafted.

15. The next significant amendment to discuss is the *Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth) (the Amending Act)*. The amendments effected by the *Amending Act* commenced operation on 18 September 2005.
16. *Part V* of the *Family Law Act 1975* concerns Jurisdiction of Courts and is comprised of ss 39–47. In relation to any proceedings, 'court' means the court exercising jurisdiction in those proceedings by virtue of that Act: s 5. *Div 1 of Part V* is comprised of s 39 alone and concerns Jurisdiction of Courts in Matrimonial Causes.
17. Subject to *Pt V* of the *Family Law Act*, jurisdiction is conferred on the Federal Circuit Court of Australia with respect to a matrimonial cause that is instituted under the *Family Law Act: ss 39(1A), (5AA) Family Law Act 1975 (Cth)*. The definition of matrimonial cause is extensive and includes a proceeding between:
 - a) parties to a marriage with respect to the property of the parties to the marriage or either of them; and
 - b) a party to a marriage and the trustee of a bankrupt party to the marriage with respect to any vested bankruptcy property in relation to the bankrupt party being, relevantly, proceedings arising out of a marital relationship. See s 4(1), *matrimonial cause, paras (ca)(i) and (cb)(i)–(iii)*.
18. The expression vested bankruptcy property is defined in s 4(1) as follows:

Vested bankruptcy property, in relation to a bankrupt, means property of the bankrupt that has vested in the bankruptcy trustee under the Bankruptcy Act 1966. For this purpose, property, has the same meaning as in the Bankruptcy Act 1966.
19. The definition of vested bankruptcy property incorporates the definition of property as provided by the *Bankruptcy Act*. By s 5(1) of that Act, 'property' is given a wide definition and includes any estate, interest or profit, present or future, vested or contingent arising out of or incident to any real or personal property.
20. *Paragraph (cb)* of the definition of matrimonial cause and the definition of Vested bankruptcy property were inserted in the *Family Law Act* by *Items 12 and 17 of Sch 1* of the *Bankruptcy and Family Law Legislation Amendment Act 2005 (Cth) (Amending Act)*.
21. One object of the *Amending Act* was to address longstanding issues concerning the interaction between family law and bankruptcy.
22. The effect of the insertion of *para (cb)* in the definition of matrimonial cause was to include proceedings between a party to a marriage and a bankruptcy trustee with respect to vested bankruptcy property.
23. Amendments proposed by the *Amending Act* were explained as follows:
 10. There are a number of difficulties which can arise when bankruptcy and family law issues and/or proceedings exist at the same time. There are inconsistencies between

family law and bankruptcy law which create uncertainty for all involved and can cause hardship for either or both creditors and non-bankrupt spouses.

11. From a bankruptcy perspective, trustees can find themselves in an uncertain position when having to resolve or reconcile competing claims. Creditors unaware of the potential property interest of a non-bankrupt spouse also suffer from a lack of certainty.

12. From a family law perspective, the legal ownership of property does not always reflect the non-financial contribution of the parties to the marriage. The special interest of the non-bankrupt spouse in the marital property created through both financial and non-financial contributions, which may be recognised by the Family Court in exercising its discretion to alter property interests, is not expressly recognised under the *Bankruptcy Act*.

13. Different outcomes result depending upon the order in which events occur (those events including separation, bankruptcy and distribution of property by the trustee in bankruptcy).

14. The amendments proposed in this Bill will address these issues by clarifying the rights of the bankruptcy trustee and the non-bankrupt spouse. Generally, the amendments will enable concurrent bankruptcy and family law proceedings to be brought together to ensure all the issues are dealt with at the same time.

24. The *Bankruptcy Act 1966* has been amended to expressly provide that the Family Court has jurisdiction in bankruptcy where the trustee in bankruptcy is an applicant for an order to set aside a financial agreement under *s 90K(1) or (3) or 90UM(1) or (6) Family Law Act (new s 35(1)(b)(ii) and 35(1A)(b)(ii))*. This is in addition to the Family Court having jurisdiction in bankruptcy where the trustee in bankruptcy is a party to property settlement proceedings under *s 79 or s 90SM*, maintenance proceedings or proceedings to set aside or vary a property settlement order under *s 79A or s 90SN FLA*.

Bankruptcy and property settlements under the Family Law Act

25. The definition of a "bankrupt" in the *Family Law Act* has been expanded to include a person who has been discharged from bankruptcy whose property remains vested in the bankruptcy trustee (*s 4(6) FLA*). These changes commenced on 26 October 2018.

26. In *Official Trustee in Bankruptcy v Mateo (2003) 127 FCR 217*, the wife of the bankrupt was served with the 139ZQ notice (requesting that she pays back the money she received pursuant to the consent orders as a property settlement with her ex-husband). She applied to the Federal Court to set aside the notice. She was successful. The Official Trustee appealed to the Full Federal Court. WILCOX, BRANSON AND MERKEL JJ wrote separate judgments. All three judges dismissed the appeal. Consideration was given by all three judges as to the extent of the reach of *ss 121 and 120 of the Bankruptcy Act* and their interplay with *ss 79 and 79A of the Family Law Act*. Branson J stated that the

remedy, if any, that was available to the Official Trustee in the circumstances was to make an application to the Family Court under s79A of the Family Law Act. Wilcox J, Branson J and Merkel J all found that the transfer pursuant to s 79 of the *Family Law Act* was not the transfer contemplated by ss 120-121 as it was made pursuant to the Court order.

27. In *Official Trustee in Bankruptcy & Galanis and Anor [2017] FAMCAFC 20*, a husband and wife purchased a property in 2002 and separated in 2011. Husband was made bankrupt in 2008 and discharged in 2011, before separation. In February 2013 husband and wife entered into a financial agreement pursuant to s 90D of the *Family Law Act*, which provided that the wife and the husband hold 60 per cent and 40 per cent legal interest in the property respectively, but that the wife is entitled to the whole of the equity in the matrimonial home, due to her contributions. In July 2013, the Official Trustee applied to the Federal Circuit Court to set aside the financial agreement and claimed 40% of the proceeds of sale, for the benefit of the creditors of the husband's bankrupt estate.
28. The primary judge dismissed the application. The Official Trustee appealed. While the Court pointed out that the trustee is permitted to stand in the shoes of a person who is a bankrupt for the purposes of participating in proceedings for the settlement of the property of the parties to the marriage, it identified that the trustee can only do so while the bankrupt is undischarged.
29. Regarding the point made in *Mateo* about consent orders not being within the scope of the claw back provisions, this conclusion is correct, in Irina Hoskinson's view, and it would stand. What the official trustee should have done is to apply to the Family Court under s 79A, to set aside the consent orders. However, the question of the jurisdiction is now clarified by those amendments, and the Trustee's application will be justified.
30. Irina believe that Galanis decision would now be reversed, because of the amendments to the definition of the bankrupt to include the discharged bankrupt.

Commissioner of Taxation v Tomaras [2018] HCA 62

31. In *Commissioner of Taxation (Cth) v Tomaras [2018] HCA 62*, the High Court unanimously dismissed the Commissioner's appeal, affirming the Full Court of the Family Court's conclusion that in relation to a debt owed to the Commonwealth by a party to a marriage, s 90AE(1) confers power on the court to make an order that the Commissioner be directed to substitute the husband for the wife in relation to that debt.
32. The High Court further held (by majority) that it was otherwise inappropriate to answer the question of law stated:
 - (i) without it being found, or agreed, that, within the meaning of s 90AE(3), the making of the order is reasonably necessary, or reasonably appropriate and adapted, to effect a division of property between the parties to the marriage, and it is not foreseeable at

the time that the order is made that to make the order would result in the debt not being paid in full; and

(ii) without the court being satisfied that, in all the circumstances, it is just and equitable to make the order.

33. Since no enquiry was made in this particular case as to the ability of the husband to pay the tax debt, the Commissioner may well be out of pocket for the tax debt and the interest owed. It is yet to be seen whether or not the ATO will set about pursuing the husband for his former wife's tax debt.
34. There may be some concern by practitioners and the tax office that the High Court has now left open the potential for tax debtors to escape their liabilities in family law property settlement proceedings. However, it must for now be taken to heart what the High Court has said in this regard, ie: that it is "not foreseeable at the time that the order is made that to make the order would result in the debt not being paid in full." It remains to be seen whether or not the Family Court treats any future applications under *s 90AE* with the appropriate practical considerations required.
35. On the other hand, the High Court's affirmation of the scope of *s 90AE* means that the Court's power to alleviate a less-financial spouse from debt burdens they simply cannot pay.
36. In any event, lawyers will need to warn their clients – particularly if they are the more financial party – that the Court can substitute them for their partner's tax debts in any property division proceedings.
37. It seems that Family Court can definitely deal with the majority of the questions concerning the property of former spouses/de facto partners. However, unfortunately, Family Court is currently under enormous strain and parties are experiencing very long delays, and it is not uncommon to wait for a full hearing for at least 2 years or more. With trustees' obligations to creditors and the regulator to administer bankrupt estates in an efficient manner, the perspective of being embroiled in the family law dispute is certainly unappealing, to say the least.
38. There is also another, possibly more significant issue in terms of the Court's approach to the division of the property. The *Bankruptcy Act* does not address the non-financial contributions of the non-bankrupt spouse, nor does it look towards the future to consider the finality of the relationship and the division of the property. It is not the role of that piece of legislation. On the other hand, The *Family Law Act* is designed to give parties the finality, to be able to draw the line and to move on. Therefore, the questions of contributions and future needs are given a lot of attention. Thus, the result of the property division may be very different should the trustee end up in the Family Court arguing over the bankrupt's share of the former matrimonial property.

Costs

39. With regards to costs, Irina draws attention to the judgment of His Honour Altobelli J in *Callas & Callas [2018] FCCA 4*, at [184]:
- 'As a general proposition, proceedings under the Family Law Act may not be the best framework for dealing with concerns about costs and expenses necessitated under the Bankruptcy Act.'
- And further:
- 'The well-established family law jurisprudence about add backs and nominal property, does not sit comfortably with the detailed statutory scheme established under the Bankruptcy Act. ... the Bankruptcy Act contains its own statutory remedies that gave transparency and accountability about the costs and expenses of administering bankrupt estates. These remedies are available, not just to the Bankrupt but even to the Applicant Wife.'
40. What His Honour is trying to say here, Irina believes, is that the *Bankruptcy Act* regime as to the Trustee's costs should govern that aspect of the litigation and that the parties, if aggrieved by the trustee's costs, should continue to seek redress in the bankruptcy jurisdiction. This should be the "go to" judgment for the trustees.

When both parties become bankrupt

41. If both parties are bankrupt, it raises the breadth of the definition of matrimonial causes and vested bankruptcy property, as well as the scope and power of the Family Court. Irinia had some involvement with the matter published under *Hankin & Anor & Nankervis [2018] FCCA 2075*. There, His Honour Kelly J was faced with the opposition by the husband's trustee in bankruptcy to the joinder in an application under s 79 of the *Family Law Act* by the wife's trustees in bankruptcy, which application was brought by the wife prior to her bankruptcy, and was being continued by the trustees after the wife became bankrupt.
42. The husband's trustee raised a number of issues which were addressed by the Court notwithstanding that the parties came to an agreement. The parties asked for the Court's approval of their consent orders and His Honour carefully analysed the following concerns of the husband's trustee:
- Jurisdiction – His Honour addressed the question as to whether the Family Court is ceased with the jurisdiction to hear the matter, considering that the matter was about the property of the bankrupt, albeit it was the proceeds of the sale of the matrimonial home. His Honour was satisfied that the proceeding was "a property settlement proceeding" as defined in s 4(1) of the *Family Law Act* (the definition of the matrimonial cause having been extended as described above). His Honour further held that it follows that the Court is empowered to make orders under s 79 of the *Family Law Act* altering the property interests of the parties and in relation to the vested bankruptcy property

- Standing of a trustee to bring or to continue proceedings under s 79 of the *Family Law Act* – not as a third party but because the chose in action vested in the trustee. His Honour looked at the definition of “property” and went through a number of cases in order to analyse whether the application under s 79 could be considered chose in action. He stated: *“I consider that, prima facie, the rights embodied in an order made pursuant to ss 79 or 114 respectively would vest in the trustee in bankruptcy upon the making of those orders, where such orders were made after the commencement of, but before discharge from, bankruptcy.”*

Conclusion

43. Irina Hoskinson believes that the legislative efforts have certainly moved the two jurisdictions in the right direction, and the parties, the trustees and the creditors can definitely have more certainty in terms of the Court powers to deal with the complex issues that arise from time to time in the property dispute. However, the questions of costs and significant delays in the Family Law jurisdiction would probably continue to dominate the trustee's decision-making process in terms of avoiding litigation if possible.

BIOGRAPHY

Irina Hoskinson

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Irina was called to the Bar in 2016. Prior to commencing private practice, Irina was a Deputy Registrar of the Supreme Court of NSW. In that role she dealt with writs of possession of property, probate and administration of deceased estates and presided over examinations. In private practice, she dealt with bankruptcy, corporate insolvency, debt recovery and family provision matters. Irina is also an adjunct lecturer at the College of Law (NSW).

Lee-Ann Walsh

Barrister, Frederick Jordan Chambers, Sydney

Lee-Ann was called to the Bar in 2012. Prior to this, she worked in the legal publishing, research and policy fields and was tipstaff and Associate in the NSW Court of Appeal. She has appeared as junior counsel in key property and commercial cases in the High Court and has developed a diverse range of practices areas including commercial, equity, property and employment law. Lee-Ann was recently appointed Editor of Hallmann's Legal Aspects of Boundary Surveying.

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