



**Australian Government**

**Insolvency and Trustee Service Australia**

## **OFFICIAL TRUSTEE PRACTICE STATEMENT**

### **INCOME CONTRIBUTIONS**

*Issued 7 February 2008*

If you have any comments, suggestions or queries on a matter referred to in this Practice Statement, please contact us at any time by [email](#) or by mail addressed to:

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## 1. OVERVIEW OF ASSESSMENT PROCESS

The purpose of the income contribution system is to require bankrupts who can afford to do so to pay contributions towards their estate and to enable trustees to recover those contributions.

The contribution system is largely administrative and includes the following key features:

- A widening of the ordinary concept of income to include fringe benefits and loans from associated entities, and money or the value of consideration received by another person as a result of work or services by the bankrupt. ([Section 139L defines income](#));
- Where bankrupts are being paid less than a reasonable remuneration or claim not to be in receipt of any remuneration trustees are empowered to determine an appropriate level of income based on their own enquiries. ([Sections 139Y and 139Z](#));
- Outstanding contributions are enforceable debts even after the bankrupt has been discharged and the trustee has access to administrative collection mechanisms including garnishee type notices issued by the Official Receiver to collect contributions. (Section 139ZL);
- The trustee can review an assessment based on hardship suffered by the bankrupt. (Section 139T);
- Decisions made by trustees are reviewable by the Inspector General; and
- Decisions of the Inspector General are reviewable by the Administrative Appeals Tribunal. (Part VI – Div 4B Subdivision G Review of Assessment)

Generally, a bankrupt whose income exceeds a statutory threshold will be required to pay contributions equivalent to 50% of the amount by which their income exceeds that threshold.

The trustee assesses the contribution liability as soon as practicable after the date of the bankruptcy and then at each 12 month interval called the contribution assessment period (CAP).

It is important that the trustee makes these assessments as early as possible to ensure the bankrupt is aware of the liability and to avoid any issues collecting arrears which would otherwise accumulate without the bankrupt's knowledge.

### The calculation

The basic formula for calculating a contributions liability is:

[Assessed Net Income less Actual Income Threshold Amount (AITA)] divided by 2.

**Assessed net income** includes [income](#) from all sources less income tax, Medicare levy and child support or maintenance payments.

**The BITA** is defined as 3.5 times the amount that is specified in column 3, item 2, Table B point 1064-B1, Pension Rate Calculator A, in the *Social Security Act 1991*.

**The AITA** is derived from the BITA adjusted by the number of dependants of the bankrupt.

The BITA is updated twice a year in March and September and is published along with the AITA amounts on ITSA's website under the heading "[Current Amounts](#)".

**The Contribution Assessment Period (CAP)** begins on the date of bankruptcy or on an anniversary of that day during the bankruptcy and normally lasts 12 months unless the bankruptcy is annulled or the bankrupt is discharged within that year. In these cases the CAP ends on discharge or annulment and the AITA apportioned for the relevant part of the year.

**A dependant** is defined in section 139K as a person who during CAP: resides with the bankrupt; is wholly or partly dependant on the bankrupt for economic support; and earned less income than the amount prescribed in regulation 6.15A. The prescribed amount is published on ITSA’s website under “[Current Amounts](#)”.

The definition of income under section 139L applies to income of a dependant. Therefore income such as the family tax benefit, baby bonus and child support payments which are not assessed for contribution purposes are also not included as income of a dependant.

A person may reside with the bankrupt for only part of the CAP and still be regarded as a dependant. For example a child may attend a boarding school or parents may have shared custody arrangements.

Where the bankrupt claims a child as a dependant for whom they also pay child support payments details should be sought of the arrangements and a decision made based on:

- How frequently the child stays with the bankrupt;
- The accommodation provided by the bankrupt for the child;
- Whether the child merely visits or has a second home with the bankrupt

**Example (using amounts current as at September 2007)**

Frank expects his gross income for the first 12 months of his bankruptcy to be \$75,000. He has one dependant.

Step 1:

The trustee calculates Frank’s net assessed net income.

Gross income	\$ 75,000.00
income tax	\$ 17,850.00*
Medicare levy	<u>\$ 1,125.00</u>
assessed net income	<b>\$ 56,025.00</b>

The Medicare levy has been applied at the rate 1.5% of gross income.

*Note: the income tax rate is at 1/7/07.*

Step 2:

The trustee works out Frank’s AITA by looking up “[Current Amounts](#)” on ITSA’s website.

AITA with 1 dependant	<b>\$45,442.39</b>
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Step 3:

The trustee uses Frank’s assessed income and AITA to calculate his annual contribution liability.

$$\$56,025.00 \quad - \quad \$45,442.39 \quad = \quad \$10,582.61$$

$$\frac{10,582.61}{2} = \$ 5,291.31$$

Frank receives a Notice of Assessment requiring him to pay

\$5,291.31 at \$203.51 per fortnight

Payment arrangements may be changed if Frank is paid monthly or his income is seasonal.

### **Documentation**

The Official Trustee may use information from the following documents in making assessments:

- Statement of Affairs
- Questionnaires issued by the Official Trustee called income statements
- Child Support Agency Payment summary and Assessment notices
- Payslips
- PAYG payment summary
- Employment separation certificates
- Employment contracts
- Tax returns
- ATO notice of assessment
- Bank statements
- Profit and loss statements
- Balance sheets
- Depreciation schedule
- Business Activity Statement

Apart from the Statement of Affairs the information in these documents is based on the financial year and can be adjusted or extrapolated to determine income for the [CAP](#).

### **Assessment Notice**

The Assessment Notice and accompanying letter must set out and explain the basis of the calculation of the liability, who to contact if the bankrupt has queries and the appeal and hardship procedures.

### **The first assessment**

The Official Trustee will assess bankrupts whose estates it is administering to determine whether they are liable to contribute or may become liable to contribute.

The first assessment is based on the information in the statement of affairs and any attachments supplied by the bankrupt and should be issued within one week of the receipt of the statement of affairs and necessary documentation.

Assessments should be issued promptly based on existing information rather than delayed pending further enquiries. A reassessment can be carried out at any stage if there is a change in income or dependants or if the assessment is incorrect.

Where no statement of affairs has been filed within a month of the date of bankruptcy the trustee may determine the bankrupt's income pursuant to section 139Z and issue an assessment on the best information available.

### **Nil assessments**

Where the Official Trustee assesses that a bankrupt has no liability to make contributions, a record of that decision, including reasons for the decision, must be kept.

If information or documents other than the statement of affairs is used to reach the decision to issue a nil assessment then that material will be identified in the record of the decision and attached to the file.

### **Subsequent assessments**

The Official Trustee will not issue subsequent assessments where:

- the initial assessment was nil; and
- the bankrupt has not been identified as a potential contributor (refer to [identification of contributors](#)); and
- no information is at hand to suggest a change in the bankrupt's circumstances.

Assessments for subsequent CAPs will be issued in all other cases.

The Official Trustee will issue a statement of income to the bankrupt one month before the end of the CAP to facilitate the assessment for the next CAP and a review of the assessment of the CAP about to expire (refer [Reassessments](#)).

The Official Trustee will generally issue new assessments within 2 weeks of the end of the CAP.

If the bankrupt does not complete a statement of income an assessment should still be issued promptly based on the previous assessment and adjusted by any known pay increases in the industry in which the bankrupt is engaged. (refer to [Objections](#) and determining income under sections 139Z and 139Y).

All assessment notices other than initial nil assessments will be forwarded to the bankrupt and include sufficient detail to show how the assessment was made and explain the review and hardship processes.

### **Reassessments (section 139W(2))**

The Official Trustee may issue a reassessment to replace an original assessment for any [CAP](#) at any time however the Official Trustee has to act in a commercially sound way so reassessments will generally only be issued if there has been a significant increase in the bankrupt's [income](#) or the number of [dependants](#) has changed or if the assessment was incorrect.

The Official Trustee may not issue a reassessment if the bankrupt's gross income has increased by less than \$1,000 because this would result in an increase in the contribution liability of only a few hundred dollars and the time and associated cost of putting in place a new payment schedule may not be justified.

If a bankrupt requests a reassessment because their income has decreased then subject to verification of the decrease the reassessment should be issued even if the change is less than \$1,000 because it would be unjust to collect more contributions than the bankrupt is obliged to pay.

The trustee is not obliged to issue reassessments for the sole reason that the BITA has changed.

If necessary new assessments or reassessments may be issued after the bankrupt is discharged pursuant to section 139WA. This provision applies only to bankruptcies occurring after 5 May 2003. In bankruptcies occurring before 5 May 2003 the trustee cannot issue a new assessment after the bankrupt's discharge, where none had previously been issued.

A reassessment for a previous [CAP](#) is calculated based on the current BITA and not the BITA that applied at the time of the original assessment.

### **Payment schedules**

The assessment notice will include a payment schedule structured to ensure prompt payments and coordinated with the bankrupt's pay period.

Instalments generally will be at least \$100 and not more than 20% of the assessed net income.

Instalments greater than 20% can be considered for high income earners.

Generally in the first instance the payment schedule will be co-ordinated with the dates on which the bankrupt receives their income however the Official Trustee will consider alternative payment schedules if it makes it easier for the bankrupt to make payments and encourages compliance.

The highest affordable payment schedule should be negotiated with the bankrupt with the aim of completing payment in less than 12 months and before the expiry of the CAP.

The Official Trustee will consider varying the payment schedule if the bankrupt's circumstances change unexpectedly for reasons that would not otherwise be dealt with under the [hardship](#) provisions. For instance if the bankrupt had a large account for mechanical repairs then payments may be temporarily reduced with the aim of resuming increased payments later and satisfying the assessment before the expiry of the CAP wherever possible.

Payment schedules which run beyond the current CAP are to be avoided if possible. When combined with assessments in subsequent periods this may result in an outstanding contribution debt at the date on which the bankrupt would otherwise be discharged. If there are arrears at this date the Official Trustee will consider lodging an **objection to discharge** which extends the bankruptcy and exposes the bankrupt to additional assessments

## **2. RIGHT OF REVIEW**

The Official Trustee will explain the bankrupt's rights and the process for requesting a review in correspondence accompanying the notice of assessment.

Bankrupts are encouraged to take up any concerns or queries they may have with their case manager or supervisor in the first instance before making a formal application for review.

Subdivision G and sections 139ZA to 139ZF provide that an assessment may be reviewed by the Inspector General on the Inspector General's initiative or at the request of a bankrupt.

Any decision made by the Inspector General may be reviewed by the Administrative Appeals Tribunal.

An application for review by a bankrupt must be in writing and addressed to the local Official Receiver. The Inspector General must make a decision within 60 days.

In making a decision the Inspector General has all the powers of the Official Trustee and may confirm the Official Trustee's decision or issue a reassessment.

If an application for review has been made and the Official Trustee agrees the assessment should be reduced then the Official Trustee should issue a reassessment promptly rather than await the outcome of the review.

### **3. IDENTIFICATION OF CONTRIBUTORS**

Many contributors are identified at the outset of the bankruptcy based on the statement of affairs however most are initially assessed as not having to pay contributions.

In most estates administered by the Official Trustee, the bankrupt is unlikely ever to have a liability to pay contributions. The circumstances of these bankrupts is unlikely to change and, as such, the Official Trustee will not send statements of income to every bankrupt on the anniversary of every CAP. To do so would be inconsistent with the trustee's duties under section 19(1)(j) and 19(1)(k).

The Official Trustee will send a statement of income in such bankruptcies where the following characteristics are present:

- Total debts disclosed in the statement of affairs greater than \$100,000; or
- Bankrupts who hold trade or professional qualifications; or
- Income disclosed in the statement of affairs is greater than \$40,000 in the 12 months before bankruptcy.

Statements of income will be sent to all bankrupts who have been previously assessed as having to contribute and all cases where the administration of the bankruptcy has not been finalised.

If a bankrupt fails to return an income statement then an objection to discharge will be lodged by the Official Trustee and under certain circumstances a referral will be made to Bankruptcy Fraud Investigation as the failure to supply an income statement may constitute an offence.

### **4. DETERMINING THE BANKRUPT'S ASSESSABLE INCOME**

The concept of income is drawn widely in bankruptcy and it is the intention of the legislation that bankrupts not be able to hide behind corporate or trust structures to conceal or divert income.

The Official Trustee assesses the income *derived* by the bankrupt which is not necessarily the same as income *received* by the bankrupt.

Section 139K defines "derived" as "...earned, derived, or received from any source, whether within or outside Australia"

Section 139L and regulation 6.12C define income as having its ordinary meaning with specific inclusions such as one off amounts like termination payments and exclusions such as child support payments

#### **Exclusions to income**

The following are not income in relation to a bankrupt:-

- Amounts received from the Child Support Reserve under the *Child Support (Registration and Collection) Act 1988*
- Amounts received for the maintenance of children in the custody of the bankrupt
- Payments under a legal aid scheme or service
- A payment or amount of family tax benefit paid under the family assistance law

- Any return on a person's investment in a superannuation fund or approved deposit fund or deferred annuity until the person reaches pension age or starts to receive a pension or annuity out of the fund.
- The value of emergency relief or like assistance.
- A payment under the *Handicapped Persons Assistance Act 1974*
- A payment under part III of the *Disability Services Act 1986* or the value of any rehabilitation program under that Part.
- Any one off payments made to carers, older Australians or veterans under a law of the Commonwealth
- Disability expenses maintenance
- Money from a funeral fund of less than \$5,000
- Rent subsidies paid by the Commonwealth or a State or Territory
- Compensation for victims of National Socialist persecution
- Payments to trainees under the Labour Market Programs
- A payment under the New Enterprise Incentive scheme
- Apprentice Wage Top –Up payments by the Commonwealth
- Government payments in relation to pharmaceutical sickness or hospital benefits or medical services and expenses
- The pay and allowances paid to members of the Naval Reserve, or Army Reserve or the Air Force Reserve other than in respect of full time continuous service.
- Payments under the Veteran's Entitlements Act
- Payments under the ABSTUDY Scheme
- Payments under the Student Financial Supplement Scheme
- Payments for jury service or witness expenses
- Payments towards the costs of personal care support services made under a scheme approved under section 35A of the *Social Security Act 1991*
- Commonwealth scholarships and payments under the *Higher Education Support Act 2003*
- Amounts credited to a person's account in an exchange trading system provided it is a community based exchange trading system operated on a not for profit basis and set up with the primary aim of helping people maintain their labour skills and keep them in touch with the labour market.
- If a person is receiving a social security benefit then any amounts received from his or her partner
- Payments under the Military Rehabilitation and Compensation Act
- The value of any benefit under the initiative known as Tools for Your Trade.

### **Allowances**

Generally allowances paid to an employee are not included as income for the purpose of contribution assessment, as the intention is that the allowance recompenses the employee for

expenses they have incurred in connection with their employment. For example tools allowance, travel and meal allowance would not be included as income.

However some allowances are in effect additional income and are not expended on work related expenses. For example a site allowance paid for working in a remote location which is paid in addition to a living away allowance may be included as assessable income if the bankrupt cannot provide evidence of related expenditure. Shift allowances and height allowances paid to construction workers may also fall into this category.

The Official Trustee will consider on a case by case basis whether the allowance is income in nature. Enquiries will be limited to and take into account the anticipated benefit to the estate.

## **Drawings**

Drawings represent amounts that owners of a business extract for their own benefit. Drawings do not represent the income or profitability of the business. Generally drawings will not be included as assessable income for contribution purposes. However in the absence of other financial information drawings may be used as a guide in determining assessable income.

## **Superannuation**

Regulation 6.12B amends the definition of income in respect of superannuation payments.

Any compulsory superannuation payments made by an employer pursuant to the *Superannuation Guarantee Charge Act 1992* or pursuant to an industrial award or a law of the Commonwealth State or Territory are not income.

However superannuation payments in excess of 9% made by an employer that arise from an industrial agreement solely between the bankrupt and the employer are taken to be income.

Superannuation payments made as part of a [salary sacrifice](#) arrangement are not compulsory and are included as assessable income. The tax paid on superannuation contributions is not income tax of the bankrupt and therefore is not deducted from the bankrupt's assessable income.

## **Inclusions to income**

Income includes salary and wages and profit from operating a business or profession and the following:

- [fringe benefits](#);
- [loans from associated entities](#);
- [income of other persons resulting from the bankrupt's services or work](#); and
- [Income determined by the Official Trustee](#)

## **Fringe benefits (section 139L(a)(v), regulation 6.12, schedule 4)**

The *Fringe Benefits Tax Assessment Act 1986* (the FBTA Act) provides a system for assessing the value of non cash benefits provided by an employer and imposing a tax on the employer. Benefits assessed under the FBTA Act also form part of a bankrupt's assessable income for contribution purposes.

It is important to note that non cash benefits may be supplied to a bankrupt by someone other than their employer and that section 139L(a)(v) of the *Bankruptcy Act 1966* includes fringe benefits provided by any person.

Typical non cash benefits include:

- Provision of a car
- Legal fees
- Debt waiver
- Free or low interest loans
- Housing costs
- School fees
- Free or discounted air travel

Benefits regarded as exempt under the FBTA Act are not part of a bankrupt's assessable income (but see [salary sacrificing](#)).

Where a benefit is supplied by an entity other than an arms length employer then the FBTA Act is modified by regulation 6.11 and schedule 4 of the Bankruptcy Act, 1966 ("the Act") so that it can be applied for contribution purposes with the effect that:

- A reference to the financial year is taken to be a reference to a CAP
- A reference to taxable value is taken to be a reference to the value of the benefit to be included as assessable income
- A reference to an employee is taken to be the bankrupt

It is important to note that where the supplier of a benefit is not an arms length employer then regulation 6.12(1) applies and schedule 4 details certain benefits which are not to be assessed as fringe benefits including:

- Benefits under a genuine maintenance agreement or order
- Orders in favour of the bankrupt for litigation costs
- Educational expenses of children
- Tax credits offset against tax liabilities
- Board and lodging or occasional domestic use of a motor vehicle provided by a close relative or brother or sister up to the value of \$250.00 per week

A close relative is defined under the FBTA Act as a spouse, child or parent or parent of a spouse.

Reportable fringe benefits are disclosed in an employee's PAYG summary. However this amount is made up of the employee's individual fringe benefit grossed up by the fringe benefit tax (currently 46.5%) which is paid by the employer and not the employee. The amount used in a contribution assessment is the grossed up amount shown in the PAYG summary less the amount of FBT paid by the employer. The FBT is calculated by multiplying the amount of the reported fringe benefit in the PAYG summary by 0.535.

#### Example

If the PAYG statement of the bankrupt shows a reportable fringe benefit of \$3,000, then the employee's actual benefit and the amount used in the contribution assessment would be \$3000 multiplied by 0.535 which equals \$1605. So in calculating the bankrupt's liability the trustee would include \$1605 as assessable income.

The grossed up reportable fringe benefit included in the PAYG summary does not form part of the tax payers taxable income but is included in the PAYG summary because this amount is used in a number of other income tests relating to government benefits.

Not all fringe benefits have to be reported in the PAYG summary. So while there may be nothing on the PAYG summary there still may be benefits to assess.

### **Salary sacrifice**

Employees often enter into salary sacrifice arrangements also known as salary packaging with their employers in which the employee agrees to forgo part of their salary in return for a benefit supplied by their employer. The employee uses part of their pre tax income to pay for the benefit which lowers the amount of income tax that they pay.

Salary sacrifice arrangements may involve [fringe benefits](#), exempt benefits and [superannuation](#).

Where the benefit is a [fringe benefit](#) the value of the benefit is added back to the post sacrifice income (that is the income less the amount sacrificed) to determine income assessable for contribution purposes.

Where the benefit is an exempt benefit or [superannuation](#) where FBT does not apply then the income assessable for contribution purposes is the pre sacrifice income (that is the bankrupt's income before it is reduced by the sacrificed amount).

The amount of income tax used in calculating the contribution assessment is based on what the bankrupt actually pays under the sacrifice arrangement and not the greater amount that would have been paid on the pre sacrifice income. (refer *Mann and Inspector General in Bankruptcy* [2001] AATA 821 (24 September 2001))

In some cases an employer requires the employee to pay any FBT however this is not income tax and nor is it a necessary work related expense. Therefore FBT is not an allowable deduction for contribution purposes.

Evidence of a salary sacrifice arrangement may not be readily apparent. For instance while the PAYG summary should include reportable fringe benefits which may indicate a sacrifice arrangement, the gross taxable income disclosed is net of the sacrificed amount.

Evidence of salary sacrifice arrangements may be found in the bankrupt's employment contract, payslips and should be disclosed in the statement of affairs and statements of income completed by the bankrupt.

### **Loans from associated entities**

Sometimes bankrupts are disclosed as borrowers from companies, trusts or third parties where the underlying nature of these transactions is actually the payment of income.

In some cases the so called loan funds are not received by the bankrupt; however are paid to another party at the direction of the bankrupt.

Section 139L(a)(vi) of the Act defines the value of these loans as income to be included in contribution assessments.

Unless fully disclosed by a bankrupt, the Official Trustee will investigate the financial records including balance sheets and loan accounts of associated entities before including the value of any loan in an assessment.

### **Money received by others resulting from the bankrupt's services or work**

Money received by a company, trust or third party resulting from the work or services of a bankrupt less any expenses (other than those of a capital nature) is assessable income of the bankrupt pursuant section 139L(a)(vii).

This section will be considered with section 139Y and 139Z below.

This provision is intended to apply where a bankrupt has established a shelf company or service company as their employer. The bankrupt provides services for which the company is paid. If the bankrupt ceased employment the company would be unable to generate little or no income. In this circumstance the company income less non capital expenses can be included as the assessable income of the bankrupt.

In *Robbins v Insolvency & Trustee Service of Australia* (unreported, AAT, Dr P Gerber, 24 December 1998) it was held that the income of the company that operated the practice and employed Dr Robbins was income of Dr Robbins.

### **Determination of income by trustee**

Sections 139Y and 139Z sometimes referred to as the deeming provisions allow a the Official Trustee to determine the assessable income of the bankrupt. These sections are read in conjunction with section 139L(a)(vii). Where the Official Trustee may not be able to establish that an associated entity receives monies primarily or substantially as a result of the work or services of the bankrupt then sections 139Y or 139Z may be applicable and may also require less investigative work.

Section 139Y provides that if a bankrupt is employed or enters into a transaction that would reasonably have produced income and the bankrupt was not paid anything or is paid an amount that is regarded as less than reasonable remuneration then the Official Trustee can issue an assessment based on an amount determined by the Official Trustee to be reasonable remuneration.

If a bankrupt has created an arrangement where a service company or discretionary trustee or third party receives substantial income primarily as a result of the bankrupt's work or services and the bankrupt is not paid or is inadequately paid then section 139 Y may be applied by the Official Trustee.

Before applying section 139Y the Official Trustee will need to carry out enquiries into the nature of the bankrupt's work and the value of that work. Relevant information will include but not be limited to:

- the trade and professional qualifications of the bankrupt;
- skills employed before bankruptcy as an indicator of the bankrupt's skills employed during bankruptcy;
- current role and responsibilities of the bankrupt;
- the region where the bankrupt is employed; and
- the age and health of the bankrupt

Having formed an opinion of the nature of the bankrupt's employment or work related activities the Official Trustee will then determine what would be reasonable remuneration. Relevant information may be obtained from:

- industrial awards relevant to the bankrupt's employment;
- current job advertisements;

- recruitment agencies;
- <http://www.wagenet.gov.au> ;
- <http://www.abs.gov.au/>; and
- trade and professional associations.

The Official Trustee will also consider whether the fact of the bankruptcy would have a negative impact on the remuneration for the work undertaken by the bankrupt.

Section 139Z provides that if a bankrupt fails to provide information about their income or claims not to be in receipt of any income and the trustee has reasonable grounds to believe the bankrupt is in receipt of income then the trustee can apply this section to issue an assessment based on income determined by the trustee. The approach in determining the bankrupt's income would be similar to that used in applying section 139Y.

Section 139Z may also be applied in relatively simple cases where for instance a bankrupt previously assessed has failed to return a statement of income for the next CAP. In these cases an assessment may be issued based on previous CAP income and consideration given to adjusting the income for any award increases or the consumer price index.

While the Official Trustee may consider using investigative provisions like section 77C to examine witnesses the Official Trustee is not required to conduct exhaustive and expensive investigations before applying sections 139Y or 139Z. Provided the Official Trustee can show that reasonable steps have been taken then the assessment should be regarded as valid. *Re Ellis; Ex parte Jefferson* (unreported, Fed Ct of Aust, Drummond J, 17 February 1995).

Any investigation in relation to sections 139Y and 139Z will take into account the duty to act on a commercial basis pursuant to sub sections 19(1)(j) and 19(1)(k).

In cases where sections 139Y and 139Z are applied the assessment notice will explain why these provisions have been applied and the basis on which the income was determined.

### **Tax refunds**

Refunds of income tax that relate to income earned before bankruptcy are assets that vest in the Official Trustee.

Refunds that relate to income earned after the date of bankruptcy are included in assessable income pursuant to section 139N.

Refunds that relate to the financial year in which the bankruptcy occurred are apportioned between pre and post bankruptcy.

Tax credits that relate to the period after the date of bankruptcy that have not yet been refunded by the Australia Taxation Office are treated as income and may also be directed to the Official Trustee pursuant to section 139ZL and applied towards the bankrupts contribution liability.

Up to the date of discharge, the ATO may apply post bankruptcy credits or refunds to any outstanding provable debt due to the ATO.

### **Foreign income**

Assessable income includes income earned or derived overseas.

The Act does not specify how income in foreign currency should be converted. The approach the Official Trustee's takes is to convert the foreign income at the exchange rate on the last day of CAP unless there has been significant fluctuations over the period, then an average of the exchange rate over the CAP is applied.

Depending on the bankrupt's employment and the country where the money is earned the bankrupt may be required to pay foreign tax rather than Australian income tax. Section 139N does not expressly include foreign income tax however the Official Trustee allows this deduction from the bankrupt's income.

## **Expenses**

The Act does not expressly provide other than in section 139L(a)(vii) for any expenses to be deducted from income. Section 139N provides that income is to be varied only by income tax, child support payments and taxation refunds; however the ordinary meaning of income includes the profit made in the ordinary course of operating a business and section 139L(a)(vii) indicates that certain expenses should be allowed.

Expenses allowed by the Australian Taxation Office for income tax purposes are not automatically allowed as expenses for contribution assessment purposes. For example expenses of a capital nature are not allowed in bankruptcy.

The issue of expenses was examined in *Newcombe v Inspector General in Bankruptcy* [2004] AATA 1320. In this case, depreciation was held to be an expense of a capital nature and not allowed; expenses associated with attending a professional seminar were considered necessary and were allowed; excessive mark ups applied to services provided by entities to a service company were allowable tax deductions but were designed to reduce tax and so were not necessarily resulting from the bankrupt's services and therefore not allowable for contribution purposes

Expenses will be examined on a case by case basis. To be allowed the expense must be necessarily incurred and result directly from the work or services carried out by the bankrupt. For example superannuation payments in excess of the amounts required to be paid by law are not necessarily incurred.

The term necessarily incurred does not mean essential. For example the costs of a professional seminar have been accepted to be necessary expense for a practising psychiatrist; however the Official Trustee may not allow the full cost of this type of expense if it involves excessive travel and accommodation costs. For instance if the bankrupt travels business class, then the Official Trustee will only allow the cost of an equivalent economy fare. If the bankrupt stays in 5 star accommodation then the Official Trustee may allow the cost of a less expensive hotel.

In *Ellis: Ex Parte Jefferson* QB 1914 of 1993 Fed no 81/95 bankruptcy, it was held that the tax paid by the recipient of money resulting from the bankrupt's services was not an expense of the bankrupt.

If a bankrupt claims self employed work related expenses then they should be able to provide a copy of Personal Services Business Determination Notice from the ATO. If a notice is not produced then the Official Trustee may be treat the bankrupt as an employee and any claimed expenses will be scrutinised accordingly

## **Income Tax and Child Support Payments**

Section 139N provides that income derived by a bankrupt is to be reduced by the amounts the bankrupt pays or is likely to be liable to pay or paid or was liable to pay in respect of income tax and the support of a child under a maintenance agreement entered into under the *Family Law Act 1975* or a maintenance order.

Section 5 defines a maintenance agreement to include agreements with the meaning of the *Family Law Act 1975* and also any other agreement with respect to the maintenance of a person that has been registered in or approved by a court in Australia.

Section 5 defines a maintenance order to include an assessment made under the *Child Support (Assessment) Act 1989*.

The phrase, "...amounts the bankrupt pays or is likely to be liable to pay or paid or was liable to pay..." used in section 139N allows the Official Trustee the flexibility needed to issue assessments for the current CAP based on projected estimates and to reassess earlier CAPs based on actual information. This also means section 139N can be applied in several different ways and so the Official Trustee will make a decision on how to apply the provision.

For those contributors receiving salaries and wages and who are therefore subject to the PAYG system, the income tax issue is relatively straight forward. The Official Trustee uses information from payslips and current taxation rates to calculate the anticipated tax payable by the bankrupt and reassess at the end of the CAP if there was any significant variation.

The taxation issue can be less straightforward for bankrupts not subject to the PAYG system such as professionals and the self employed whose income is not regular and may not be received in the period it was earned. These people may declare their income for taxation purposes on an accrual or cash basis and often have significant tax deductions. In these cases the Official Trustee will normally require copies of taxation returns, income tax assessment notices, financial statements and bank statements to determine the amount of tax the bankrupt pays or is likely to be liable to pay, or paid or was liable to pay as the case may be. In these situations the Official Trustee will take a case by case approach ensuring that any contribution assessment does not interfere with the bankrupt's ability to pay their taxes and does not give an advantage to a bankrupt by deducting amounts for tax that are never actually paid.

As an example at the end of CAP1 the Official Trustee can reassess CAP1 based on what the bankrupt actually paid and assess CAP2 based on the tax the bankrupt should pay for that period plus any amount of tax outstanding from the earlier period.

Alternatively, the Official Trustee will use the amount of tax the bankrupt should have paid in CAP1 in the assessment of CAP1 irrespective of what the bankrupt did or didn't pay. The CAP2 assessment would then only include the amount of tax they should become liable for in CAP2 in the assessment of CAP2 and not include any outstanding amounts from the previous period.

All other things being equal both approaches result in the same total income assessment for CAP1 and CAP2. The difference is in effect one of timing.

When it comes to the last CAP the Official Trustee may consider reassessments for previous CAPs based on the amount of tax actually paid by the bankrupt so the bankrupt does not receive an advantage by deliberately deferring or failing to pay tax.

The Official Trustee is aware that in the last CAP some bankrupts may deliberately overpay tax so the amount of tax deducted is increased and the contribution liability decreased. The bankrupt may then receive a tax refund after discharge equal to the excessive tax paid in the last CAP. In these cases the Official Trustee will issue the assessment based on the tax calculated as the liability payable by the bankrupt and if necessary re assessments will be issued after the date of discharge.

In some cases where the bankrupt does not cooperate and provide information about taxation, the Official Trustee will undertake further enquiries. In these cases even though an assessment is largely based on information derived from enquiries rather than provided by the bankrupt the Official Trustee will show how the assessment was made and in the absence or cooperation from the bankrupt and any better information the assessment is valid and enforceable. *Re: Gareth John Ellis Ex Parte: Philip Gregory Jefferson and Jay Arscott Stevenson* No. QB1914 of 1993 FED No. 81/95.

The notice of assessment will include sufficient detail so that the bankrupt can understand the basis of the calculations. The notice will show how the figures for income, expenses and taxation were derived. *Schiffer v Pattison* [2005] FCA 494 (26 April 2005).

The Official Trustee only deducts the tax payable by the bankrupt based on their taxable income and does not include any amount for tax on additional income and benefits assessed by the Official Trustee. *Thomas Robbins and Insolvency and Trustee Service Australia* AAT No 13585 [1998] AATA 1003 24 December 1998. *Mann and Inspector-General in Bankruptcy* [2001] AATA 821 (24 September 2001).

In summary the Official Trustee will deal with income tax on the following basis:

- Consistent treatment throughout the bankruptcy;
- Recognising the bankrupt's obligation and capacity to pay tax;
- Avoid double counting; and
- Based on income declared for taxation purposes.

## **5. HARDSHIP**

Section 139T provides that a bankrupt may make application on hardship grounds to the Official Trustee for a variation of their contribution liability.

There are limited grounds on which any application can be made. These are summarised as:

- Ongoing medical expenses
- Child care costs essential for the bankrupt to work
- High rent for non public housing
- Substantial expenses incurred in travelling to and from work
- Loss of contribution from someone who lives with the bankrupt and contributes to household costs.
- Any other reason specified in the regulations. (Note: currently there are no reasons specified in the regulations)

There is no prescribed form for the hardship application however generally it should be in writing and the Act stipulates that the trustee should make no determination unless the bankrupt provides evidence of the matters that they rely on as reasons for a variation. The Official Trustee can provide assistance to people who wish to make a hardship application.

The Act provides that the trustee must make a decision as soon as practicable and within 30 days. In practice hardship reviews will be completed within 14 days of receipt of all necessary information.

Where a hardship review decision is not made within 30 days of receipt of the application, the Act provides that the application has been refused by the trustee.

If a hardship review decision is not made within 30 days because of delay by the Official Trustee then injustice can occur if the decision would have otherwise been to grant hardship. The bankrupt will be advised of the delay and of their appeal rights. As the bankrupt is not prevented from lodging a fresh application they will be asked whether they wish to do so.

The Official Trustee must be satisfied that imposition of the contribution liability will result in hardship; that the bankrupt is required to meet the expense of the type specified in section 139T and that the expenditure is not discretionary expenditure before an adjustment will be made on the basis of hardship.

For example a bankrupt may choose to live in an affluent suburb and pay high rent as a result. This would appear to be a discretionary life style choice. The Official Trustee may then investigate the median market rental of accommodation reasonably necessary for the bankrupt's household in the region in which they live. The difference between the high rental paid by the bankrupt and the median market rental would be considered discretionary expenditure and not allowed in a hardship application.

If the bankrupt can establish that it is necessary for them to pay high rent due to the remote location and the need to live close to their employment, then they must still satisfy the Official Trustee that payment of the contribution assessment will cause hardship. It may be that the bankrupt's income is sufficiently high so they can pay the high rent and the contribution liability without undue hardship. To determine this, the Official Trustee would normally request the bankrupt to supply details of all of their discretionary and non discretionary expenditure typically in the form of a fortnightly or monthly household budget. The difference between the bankrupt's income and non discretionary expenditure would then be considered by the Official Trustee in determining the bankrupt's capacity to pay the contribution assessment and whether this will cause hardship.

If the Official Trustee is satisfied that the bankrupt will suffer hardship then the Act provides that the trustee can vary the AITA and make an assessment under section 139W to give effect to the decision and reduce the contribution liability.

For example if the bankrupt has ongoing medical expenses of \$3,000 per year and suffers hardship, then the contribution liability will be decreased by \$3,000. This is achieved by the Official Trustee increasing the AITA by \$6,000 and issuing an amended assessment.

The Official Trustee must give written notice of the decision to the bankrupt including details of the reasons and evidence and material relied on to reach the decision. The notice will include information about how they can appeal to the Inspector General for a review of the Official Trustee's decision.

## **6. COLLECTION AND ENFORCEMENT**

### **Investigations**

Investigations to determine a bankrupt's income and their liability to contribute will only be carried out where it is expected to result in a cost effective return for the estate (refer section 19(1)(j) and 19(1)(j)).

The following provisions under the Act may be used to investigate bankrupts' financial affairs:

Section 77	Duty of bankrupt to provide information
Section 78	Arrest of a bankrupt for failing to comply with an obligation under the Act
Section	Access to premises by Official

77AA	Receiver to remove and copy documents
Section 77A	Associated entities to provide documents to the trustee
Section 77C	Examination under oath before Official Receiver
Section 81	Public examination in court
Section 139V	Information and books to be provided to the trustee

The ability of the Official Trustee to issue valid enforceable assessments is not affected by a bankrupt's failure to cooperate and provide information. Nor does the Official Trustee have to carry out expensive and time consuming investigations before issuing an assessment.

Provided the Official Trustee can show how the assessment was made then in the absence or cooperation from the bankrupt and any better information the assessment is valid and enforceable. *Re: Gareth John Ellis Ex Parte: Philip Gregory Jefferson and Jay Arscott Stevenson* No. QB1914 of 1993 FED No. 81/95.

### **Arrears**

Arrears occur when a bankrupt has not made payments towards an outstanding contribution liability in accordance with the [payment schedule](#) set by the Official Trustee.

The Official Trustee will act promptly to collect arrears as generally any delays make the collection of arrears more difficult.

The overall objective is to have all outstanding contributions collected before the bankrupt is discharged.

The Official Trustee will maintain a record of all contact with the bankrupt regarding the collection of arrears and the reasons for any renegotiated payment schedule.

The Official Trustee will advise the bankrupt within 7 days of the bankrupt falling behind with payments unless the bankrupt has negotiated a temporary suspension of payments due to extenuating circumstances. This information will be recorded on the Official Trustee's file.

This communication will advise the bankrupt that an objection may be lodged and/or a section 139ZL garnishee notice served on their employer and/or third party who holds monies/property on behalf of the bankrupt eg. Australian Taxation Office in respect of post bankruptcy refunds, banks and other financial institutions or individuals, provided the amount is greater than \$1,000.

If the bankrupt fails to make good the arrears or negotiate a new payment schedule within 14 days of the arrears letter, an [objection](#) may be lodged and an application made to the Official Receiver for the issue of a section 139ZL notice.

Section 139ZL notices are only issued upon payment of a fee to the Official Receiver; therefore these notices will only be used where it is cost effective. The Official Trustee will consider the bankrupt's history of payments, the amount of the arrears and the total amount of the contributions

liability which is yet to be paid. Generally section 139ZL notices will only be sought if the total outstanding contribution liability is more than \$1,000.

In collecting arrears the Official Trustee will comply with the minimum standards set out in the “Debt Collection Guideline: for collectors and creditors” which is published jointly by the ACCC and ASIC. This guideline is available online and provides practical guidance to creditors including government agencies on how the Commonwealth consumer protection laws apply to collection. For example it refers to when and how many times a collector may telephone a debtor.

In most cases it is not cost effective to pursue vigorously arrears less than \$1,000; however objections to discharge will be considered in these cases.

In cases where the arrears are substantial other avenues for collection include:

- Applying to have the contribution debt recognised and enforced as a judgment debt
- Sequestration order (making the debtor bankrupt again)
- Instructing a debt collection agency
- [Supervised account regime](#) (requiring the bankrupt to open a bank account and pay in all cash income)

Section 19(1)(j) and 19(1)(k) apply and these steps will only be taken if it is cost effective.

## **Objections**

Objections to discharge are an effective and efficient way to induce a bankrupt to comply with their obligations to provide information and pay contributions.

Although objections can be lodged at any stage before discharge they will generally be lodged promptly after the bankrupt has failed to return a statement of income or provide other information or when in [arrears](#) for a period greater than 3 weeks unless it is apparent that the bankrupt has or may have a reasonable excuse for not complying with their obligations..

The Official Trustee will generally only advise the bankrupt in writing once that an objection may be lodged before doing so.

Objections will be withdrawn where the bankrupt has met their obligations. An exception to this rule will occur where the bankrupt is meeting a renegotiated payment schedule but has a persistent history of arrears and has not yet caught up with the original arrears.

Objections will be considered during the third CAP where the bankrupt has a history of arrears and it is considered likely that the contribution liability will not be paid within 3 months after the third anniversary of the bankruptcy.

Objections lodged solely on the grounds of unpaid contributions in place after the third anniversary of the bankruptcy will be withdrawn by the Official Trustee as soon as the bankrupt has paid all outstanding contributions.

If an objection is in place after the third anniversary of the bankruptcy then the Official Trustee will continue to issue and collect assessments for CAP4 and beyond while the bankrupt is undischarged.

## Supervised Account Regime

Where the bankrupt has failed to comply with the obligation to pay contributions and s139ZL notices are not effective, the Official Trustee will consider using the supervised account regime (SAR).

A determination that the SAR applies to a bankrupt will not be made unless, at the time of making the determination, the bankrupt is liable to pay an income contribution and either:

- where the contribution is payable by instalments, the bankrupt has not paid the whole of an instalment when it became payable; or
- where the contribution is payable at a specified time, the bankrupt has not paid the whole of the contribution at that time

The SAR is intended to be applied in a small number of cases typically where the bankrupt is self employed and has failed to meet his or her obligations voluntarily and other collection methods have been or are likely to be unsuccessful.

The Official Trustee will come to an arrangement with the bankrupt allowing for regular withdrawals from the account to meet the bankrupt's living expenses while ensuring that the balance of the account remains sufficient to meet the bankrupt's liability to pay contributions. Generally, it is intended that the Official Trustee will consent to regular or periodic withdrawals from the account and that the Official Trustee will not consent to the bankrupt withdrawing amounts in excess of that required to meet the contributions liability. In addition to this ongoing consent to meet living expenses, the Official Trustee may also consent to additional withdrawals to meet unexpected liabilities or where a balance has accumulated in the account which exceeds the amount required to meet the bankrupt's contribution liability.

The bankrupt is prohibited from entering into non monetary or constructive receipt arrangements and must obtain the trustee's consent in order to continue with such arrangements where the effect is that income derived by a bankrupt is not actually received by the bankrupt because it is:

- reinvested, accumulated or capitalised; or
- dealt with on behalf of the bankrupt or as the bankrupt directs.

This is to ensure that income derived by the bankrupt is actually received by the bankrupt in monetary form so that the SAR can apply effectively and the amount available for payment of the bankrupt's contributions liability is maximised.

A determination will cease to be in force where the bankruptcy is annulled and where the bankrupt is discharged and there is no further liability to pay a contribution. Where the bankrupt is discharged from bankruptcy and has an outstanding contributions liability, the determination will cease to be in force only when the bankrupt is no longer liable to pay a contribution.

Approved forms must be used. These are the Supervised Account Notice; the Supervised Account Notice Determination; and the Revocation of Supervised Account Notice. There is also a document which explains the effects of ss139ZIE-139ZIT. Although this document is not an approved form, pursuant to s139ZIC(4)(b), it must accompany the Determination and Supervised Account Notice.

All decisions made by the Official Trustee under the provisions relating to the SAR are subject to review by the Inspector-General and the AAT.

Non-compliance with the requirements under this regime is an offence punishable by imprisonments for 6 months. Any instances of non compliance will be referred to Bankruptcy Fraud Investigation.