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PROTECTING ASSETS FROM CREDITORS

Introduction

Any individual in business inevitably incurs debts in the operation of the business. Debts may be incurred voluntarily, such as a house mortgage or the guarantee of a business overdraft. They may also be incurred without the individual's knowledge, such as liability for the acts of partners.

The law recognises that individuals may take steps to protect their assets. Asset protection is about structures to protect an individual's assets from the consequences of business failure. Asset protection provides a fence at the top of the cliff rather than an ambulance at the bottom.

In order to be effective, steps need to be taken to protect assets whilst the business is successful. Once the business begins to fail, it is generally too late to take steps to protect assets from potential creditors.

The steps that may be taken will depend upon the potential exposure of the individual and the type of creditor likely to be involved. The success of any steps taken will ultimately depend upon the value attributed to any transfer of assets, the timing of the transfer and the structure chosen.

Trusts

A trust is an obligation imposed on one person (the trustee) to hold property on behalf of and for the benefit of others (the beneficiaries). Assets are transferred to the trust in return for a debt back from the trust to the person transferring the asset. The debt back is an asset of the transferor, which can be gifted.

A trust is a separate legal entity. Any assets in a trust will generally not be required to be sold to pay business debts.

The trust is an important asset protection tool if used wisely and as early as possible, and provided the person transferring the assets to the trust is not doing so as an attempt to avoid creditors.

Relationship Property Agreements

Family assets should not be compromised by business trading, however banks often require the family home to be used as security for business debts. The Property (Relationships) Act allows couples (either married or de facto couples) to enter into a Relationship Property Agreement, to define what assets are relationship property and what are separate property.

A Relationship Property Agreement can be a useful tool for protecting family assets. The business operated by one spouse can be separated out from the family home, thus leaving the other spouse's interest in relationship property free from attack should the business fail. As long as the couple are not both active in the business, this will be an effective asset protection tool.

Relationship property agreements can be ineffective against creditors if an intention to defraud creditors can be shown.

The transfer of assets made by way of the agreement attracts no gift duty and there is no debt back to the transferor as a result of the transaction which would constitute an asset available to creditors.

Joint Family Homes

A joint family home is one registered as such under the provisions of the Joint Family Homes Act 1964 (the Act). Registration under the Act is different from mere joint ownership.

Registration as a joint family home affords a degree of protection from creditors. It creates a protected fund of $103,000 equity in the home which is protected against unsecured creditors.

Incorporation

The most simple form of asset protection is to incorporate a company to operate the trading business. Incorporation will not give protection from a creditor who has obtained a personal guarantee from the directors of the company.

Often landlords and bankers will require personal guarantees, and incorporation will provide no protection in those circumstances, but it may provide protection from trading debts that are not personally guaranteed.

Transactions that can be Set Aside or Reversed

Steps taken to protect assets from creditors can be set aside and reversed under at least three (3) pieces of legislation:

1. The Insolvency Act 2006;
2. The Property Law Act 2007; and
3. The Property (Relationships) Act 1976.

The Insolvency Act 2006

The Insolvency Act provides that the court may reverse a transaction if it was made within two years of the person's bankruptcy and was a transaction by the bankrupt that was entered into at a time when the bankrupt was unable to pay his or her debts and enabled a creditor to receive more towards satisfaction of a debt by the bankrupt than that person would be likely to receive in the bankruptcy.

A transaction includes:

- conveying or transferring the bankrupt's property;
- giving a charge over the bankrupt's property;
- incurring an obligation;
- undergoing an execution process;
- paying money (including money paid in accordance with a judgment or an order of a court);
- anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it.

The Insolvency Act also provides that any gift of property may be reversed by the Official Assignee if the person making the gift becomes bankrupt within two (2) years. In some cases this can be extended to five (5) years.

The Property Law Act 2007

The Property Law Act 2007 provides that a creditor may seek compensation for, or apply to set aside, any disposition of property made with intent to prejudice creditors or by way of gift, or without receiving reasonably equivalent value in exchange, provided the debtor:

- was insolvent at the time, or became insolvent as a result of making the disposition, or
- was engaged, or was about to be engaged, in a business or transaction for which the remaining assets of the debtor were, given the nature of the business or transaction, unreasonably small, or
- intended to incur debts beyond his or her ability to pay.

The Property (Relationships) Act 1976

The Property (Relationships) Act provides that any transaction between a husband and wife, or de facto couple, with respect to relationship property where there is an intent to defraud creditors may be set aside and reversed by creditors and the Official Assignee.

Summary

Individuals in business are able to take steps to provide asset protection against future business failure.

Taking such steps is obviously sound business practice and warrants investigation in consultation with your lawyer.

In deciding whether to take such steps an individual should ask themselves the following questions:

- In the event of my business failing, do I have in place the maximum available protection for my family against claims by creditors?
- Do I have sufficient control over my business to ensure that my actions alone will determine the continuing success or otherwise of my business?
- Have I discussed with my professional advisors what steps they would recommend (if any) to safeguard or further safeguard my assets in the event of business failure?

If you have specific questions, or need legal advice on a particular issue, please contact Cathy Fisher or Shafraz Khan at Fortune Manning Lawyers. Cathy and Shafraz have extensive experience in all areas of the law relating to the transport industry.

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