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### *Bankruptcy and “Reasonable Income” (Related Party Employers)*

#### **Background**

Section 139Y of the Bankruptcy Act 1966 provides a “Trustee may regard a Bankrupt as receiving reasonable income”, in conflict to what they may disclose in their tax returns.

In summary this means that a Bankrupt may be deemed as receiving “Reasonable Income” in their employ even though they may not have physically received payment.

This is rarely an issue where the Bankrupt and their employer are unrelated arms length parties, but unfortunately very common where the two are related.

#### **Example 1**

- Pre Bankruptcy, Bankrupt worked as a mining contractor earning approx. \$200k p.a.
- Post Bankruptcy, employed as sole employee of wife’s Company performing the same services
- Wife’s Company receives approx. \$200k for services and Bankrupt was paid \$42k p.a.
- Bankrupt assessed at \$200k and as the Bankrupt has not paid tax on the \$200k, but only on the \$42k, for the purpose of his subsequent assessment, it is only that actually paid that he is entitled to claim for the purpose of the Trustee’s assessment, which under this scenario would see him paying a contribution of \$67,816 for the year as against \$37,286 had he not endeavoured to structure his affairs to defeat those contribution obligations.

#### **Example 2**

- Bankrupt employed under a Discretionary Trust structure
- Bankrupt deemed to once again receive a disproportionate distribution from the Trust for the value of their net worth to the Trust.
- Bankrupt’s distribution also adjusted for expenses not necessarily incurred plus depreciation and other capital purchases for the purpose of their distribution.
- Bankrupt deemed as receiving “Reasonable Income” from the Trust, in excess that reflected within their tax return, with once again the allowance in respect to tax paid only to the extent of that actually paid & not on the increased gross figure.

#### **Summary**

In brief, should a Bankrupt deliberately endeavour to structure their affairs in an attempt to defeat any obligation they may have under the Act, they are at risk of the Trustee lodging an Objection to their Discharge from Bankruptcy and exposed to increased contribution obligations.

**As always, if you or your clients need advice on any business turnaround or insolvency matters do not hesitate to contact us.**

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