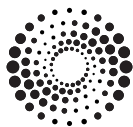


The Law Handbook

YOUR PRACTICAL GUIDE TO THE LAW IN NEW SOUTH WALES

15th EDITION



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Bankruptcy

Andrew O'Brien – Barrister

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[6.10] Bankruptcy was originally designed to keep people out of jail when they could not pay their debts. It relieves people of most of their liabilities to their unsecured creditors, and enables them to make a fresh start in their financial affairs. It is also a means of debt recovery for some creditors.

When someone becomes bankrupt, a trustee takes over their financial affairs. Among other things, the trustee can sell some of their property, carry on their business for a time and sue for debts owed to them.

Probably the best way to understand bankruptcy is to see it as an exchange. In return for protection from further legal action by creditors and, usually, a total release from debts at the end of the bankruptcy, the debtor gives certain assets and (temporarily) a large degree of control over their financial affairs to the trustee.

The law on bankruptcy is found in the *Bankruptcy Act 1966* (Cth), which applies throughout Australia.

Alternatives to bankruptcy

[6.20] An *insolvent* person (a person who cannot pay their debts as they fall due) need not always become bankrupt. The alternatives for debtors who, if given some breathing space, can work their way out of insolvency, are:

- informal arrangements;
- debt agreements under Pt IX of the *Act*;
- personal insolvency agreements under Pt X of the *Act*.

These options should be thoroughly explored with a solicitor, accountant or financial adviser before a person voluntarily enters bankruptcy. It should be noted that some of those alternatives carry with them some of same consequences that follow on becoming bankrupt. Those consequences can affect a person's ability to maintain their employment, hold particular positions and offices and, of course, obtain credit.

[6.30] Informal arrangements

The first, and most preferable alternative, is an informal arrangement with creditors, usually organised by a financial counsellor or, perhaps, an accountant or solicitor.

An informal arrangement costs less to administer than a formal arrangement, but it won't work unless all the creditors agree. If one creditor takes recovery action, the proposal will be unworkable. It must therefore be realistic, and it should be done as soon as the debtor finds they cannot meet their monthly commitments. It is usually too late when one or more of the creditors has commenced recovery proceedings.

[6.40] Part IX debt agreements

Debt agreements are available only to people with fairly small debts (at September 2019, the amount is \$115,733.80), few assets (at September 2019, the amount is \$231,467.60) and low incomes (at September 2019, the amount is \$86,800.35). The limits are updated semiannually in March and September.

Debt agreements are organised by the *Official Receiver* (see Who's who in bankruptcy at [6.70]), and are generally administered by debt agreement administrators. They can also be administered by:

- the Official Trustee; or
- a registered trustee.

Fees

The Official Receiver charges, as at September 2009, \$200 for setting up a debt agreement. Fees are payable for administering it (20% of the value of the proposal accepted by creditors). Consultants and debt agreement administrators who help debtors to formulate proposals and lodge them with the Official Receiver also charge a fee.

What the agreement should be about

The agreement deals with any aspect of a debtor's financial affairs; for example, it could provide for a compromise of their debts, a moratorium or a sale of property, or be limited to the debtor's undertaking to obtain financial advice.

Creditors want to be paid, if only in part. They are more likely to be interested in proposals that involve payment of at least part of the debt

than proposals offering only moratoriums or undertakings to obtain advice. Indeed, creditors have been known to accept proposals that only result in them recovering a few cents for each dollar owed.

Limitations on Pt IX agreements

A person cannot make a Pt IX agreement if they have at any time in the past 10 years been bankrupt, or entered into a Pt IX, or given an authority to appoint a controlling trustee under Pt X (see [6.50]).

Proposing an agreement

The proposal should be made as soon as possible, while creditors are still prepared to listen. The main selling point is that they will get a better return from a debt agreement than from the alternatives (in most cases, at least some return) because administration costs are much less than for a bankruptcy or a Pt X proposal.

[6.50] Part X personal insolvency agreement proposals

The third alternative to bankruptcy is a proposal under Pt X of the *Act*. This can be administered by a registered trustee or the Official Trustee.

Since December 2004, the three previous forms of Pt X proposals (assignment, arrangement and composition) have been merged into a single form: *personal insolvency agreements*.

S188A of the *Act* prescribes the required contents of personal insolvency agreements, which may also have optional contents. The proposal can be flexible and can offer certain creditors a larger or smaller dividend than other creditors.

The proposal must be achievable and realistic. It should be made before creditors commence recovery action, while debtor and creditors are still on speaking terms.

Procedure

The s 188 authority

The debtor completes a s 188 *authority*, which authorises a solicitor, a registered trustee or the Official Trustee to take control of their property and call a meeting of creditors to consider their proposal for a personal insolvency agreement.

The authority must be accompanied by:

- a statement of affairs completed by the debtor;
- a draft personal insolvency agreement containing the proposal of how the debtor's affairs will be dealt with.

The authority becomes effective when it is signed by the solicitor, registered trustee or Official Trustee, who thereby consents to become the *controlling trustee*.

The controlling trustee

The controlling trustee is required to:

- investigate the debtor's financial affairs;
- prepare a report to creditors informing them of what they can expect to receive from the proposed agreement and the trustee's fees to administer it, compared with what they could expect to receive if the debtor instead became bankrupt.

The creditors' meeting

Creditors are invited to a meeting to vote on the proposal. A *special resolution* must be passed (by at least 51% of creditors having at least 75% of the value of the debts, voting in person or by proxy) for it to be accepted.

Once the resulting deed is executed by the debtor, it is binding on all creditors.

Creditors should attend the meeting, either in person or by proxy, and seek further information about the proposal – particularly the trustee's fees, which are paid before the creditors receive any payment.

Trustees' fees

The fees for administering a personal insolvency agreement are usually charged on an hourly rate – if the proposal will operate for some time (eg, three years) they could be substantial. Creditors can set a limit for the trustee's fees by resolution. The Official Trustee's fees are set by the *Bankruptcy Act and Regulations*.

A solicitor cannot be a trustee

While a solicitor can act as a controlling trustee to set up the personal insolvency agreement, a solicitor cannot act as the trustee of the agreement.

When a proposal has been accepted

The debtor is required to execute the personal insolvency agreement by way of a deed within

21 days of creditors resolving to accept the proposal. The debtor will be released from their debts in accordance with the terms of the agreement (one of the essential terms).

A personal insolvency agreement cannot release the debtor from debts they would not be released from by becoming bankrupt.

Declarations of intention

Subject to certain exceptions, a debtor may give the Official Receiver (see *Who's who in bankruptcy* at [6.70]) a declaration of their intention to present a *debtor's petition* (*Bankruptcy Act*, s 54A). Once accepted, this has the effect of freezing legal action (such as writs of execution and garnishee orders) for 21 days, which may give the debtor time to seek advice or make arrangements with creditors,

and avoid bankruptcy. Alternatively, the debtor may present a debtor's petition, which will stop the writ of execution or garnishee permanently. Creditors can often be persuaded that it is better to reach a compromise and let the debtor continue without being declared bankrupt.

These arrangements do not affect the rights of secured creditors to deal with their security, and are not available to business partners. A declaration of intention can be filed only once in any 12-month period.

Filing a declaration does not mean the debtor must present a debtor's petition and become bankrupt. It is, however, an *act of bankruptcy* (ie, an act showing that the person may not be able to pay their debts).

Entering bankruptcy

[6.60] Who can become bankrupt?

Only individuals can become bankrupt and they must have a connection with Australia by way of residence or business.

Spouses

A married person's bankruptcy has no effect on their spouse unless the spouse:

- has guaranteed a debt of the bankrupt; or
- is jointly liable for a debt and/or jointly owns divisible property with the bankrupt.

In such cases, the creditor can normally require the spouse to pay the total debt, which would, it can be expected, usually lead to the spouse also becoming bankrupt.

Children

A child (a person under 18) can enter bankruptcy voluntarily, but can be made bankrupt only if there is an *enforceable debt* (in most cases, only contracts for necessary goods or services are enforceable against children).

Necessaries

The legal definition of necessary goods and services (necessaries) is complex. It appears in practice that trustees decide whether goods or services are

necessary, and are generally sympathetic to children in these circumstances. A trustee might regard food, clothing and accommodation as necessaries, but not items such as cars, electrical goods or even trade debts.

Non-citizens

People who are not Australian citizens can become or be made bankrupt and have their assets in Australia made available to their Australian creditors (*Bankruptcy Act*, s 43).

Assets outside Australia may also be available to Australian creditors – this depends on the law of the country where the assets are located.

People with a mental illness or intellectual disability

A person with a mental illness or intellectual disability cannot commit an *act of bankruptcy* (see *Declarations of intention* at [6.50]), and so cannot be bankrupted by a creditor. However, the affairs of such a person may be placed in bankruptcy by someone acting for them (s 308(c)).

Partnerships

In the case of a partnership, or two or more people trading under a business name, it is not the firm but the people who are made bankrupt.

Companies

Companies cannot become bankrupt under the *Bankruptcy Act* – they are wound up (or *liquidated*) under the federal *Corporations Act 2001* (Cth).

People who are not insolvent

Sometimes people who are not insolvent – people with enough money or property to pay their debts – are made bankrupt because they take no action when a bankruptcy notice or petition is issued against them. Though they might pay the debts and obtain a discharge or annulment (cancellation), the disadvantages of having been made bankrupt remain.

[6.70] Becoming bankrupt voluntarily

Deciding to become bankrupt

Anyone who has a *provable debt* (see [6.250]) of any amount can apply to enter bankruptcy voluntarily. The decision should only be made after getting the best available advice, and considering the advantages and disadvantages (see [6.90] for a summary of what these are).

Procedure

Having decided to go ahead, the debtor should complete:

- a debtor's petition; and
- a statement of affairs.

Forms can be obtained from the Australian Financial Security Authority (AFSA), its website or a legal stationer.

The forms can be filed personally at the AFSA or sent by mail or email to the Official Receiver (see Who's who in bankruptcy at [6.70] for who this is), who accepts the forms and allocates a bankruptcy number. There is no fee.

The statement of affairs

All liabilities, provable or not, must be disclosed in the statement of affairs. The value of the debtor's interest in assets must also be shown; for example, the debtor's interest in jointly owned household furniture valued at \$5,000 should be shown as a half-share worth \$2,500. It is an offence to not make full and correct disclosure when completing a statement of affairs.

Who might consider bankruptcy

People for whom bankruptcy may be a good idea include:

- pensioners who do not own a home, have household goods on credit (but not subject to a consumer mortgage or under a bill of sale), are unlikely to earn other substantial income in the near future, and are being harassed by creditors;
- people whose spouses have died or deserted them, who have debts of their own and who are otherwise in the same position as someone on social security benefits (however, if the debts are the responsibility of the other spouse, whether living or dead, bankruptcy may not be necessary);
- low wage earners, especially if they have a large family, pressing debt problems and heavy additional expenses, such as a child with a disability;
- people whose business venture has failed and cannot be salvaged, and who do not have the means to pay their debts.

A debtor who would not benefit from bankruptcy may be able to arrange with creditors to pay all, or part, of the debt by instalments. However, this does not prevent a creditor from taking bankruptcy action. If the debtor does become bankrupt, any money paid to a creditor may be recovered later by the trustee (see [6.120]).

Joint debts

For a couple (married or not) who have joint debts and wish to become bankrupt, it is simpler to lodge separate debtor's petitions and statements of affairs. Joint debts should be shown in full in each statement, because each joint debtor is fully liable for payment and the liability cannot be divided (eg, a joint debt of \$6,000 should be shown on each individual statement as \$6,000).

For joint secured debts, the total amount of the debt less the value of the security is used to calculate the amount owing. Each debtor is responsible for the total debt, and should show it in full. Their equity in the asset, if any, is shared, and the value of the equity should be stated to show each person's share of the asset.

When the debtor's petition may be rejected

The Official Receiver has the discretion to reject the petition if, from the debtor's information, it

appears that the debtor would be able to pay their debts within a reasonable time, and that either:

- the debtor is unwilling to pay one or more of the debts; or
- they have previously become bankrupt on a debtor's petition:
 - three or more times; or
 - once in the past five years.

The Official Receiver may also reject the petition if the debtor does not have an association with Australia – that is, they are not present or do not live in Australia, do not have a house in Australia or carry on business in Australia.

Who's who in bankruptcy

Registered ("private") trustees

Private trustees are accountants in private practice registered with the Australian Financial Security Authority to act as trustees of bankrupt estates.

A person wishing to appoint a private trustee must first obtain the trustee's written consent. Trustees will generally only act if there is enough money or assets to pay their fees. They are entitled to a minimum fee (currently \$4,000) payable from moneys in the bankrupt estate without having to seek the permission of creditors, plus 20% of the money received by the trustee.

A list of registered trustees is available from the Official Receiver and the Australian Financial Security Authority website.

The Official Trustee in Bankruptcy

The Official Trustee in Bankruptcy is part of the Australian Financial Security Authority, an executive agency in the federal Attorney-General's portfolio.

If there is no private trustee, the Official Trustee automatically becomes the trustee. If assets are sold or payments made by the bankrupt towards their debts, the Official Trustee's fees, which are calculated on a percentage of the funds received into the estate, are paid first. However, on release from bankruptcy the person does not owe fees to the Official Trustee, even if no funds were received into the estate.

The Official Receiver

Official Receivers act in the name and on behalf of the Official Trustee. Prior to August 2010, Official Receivers administered bankruptcy districts: each state of Australia was a bankruptcy district for the purposes of the *Bankruptcy Act*. However, since that date, there are no longer bankruptcy districts and there are only two Official Receivers being located in Sydney and Brisbane.

Official Receivers accept debtors' petitions, issue bankruptcy notices and maintain the National Personal Insolvency Index (NPII).

Official Receivers also have powers to issue notices on behalf of all trustees to help them recover assets and obtain information.

The Inspector-General in Bankruptcy

The Inspector-General in Bankruptcy is the head of bankruptcy administration in Australia, and can inquire into, and investigate, bankruptcy procedures (*Bankruptcy Act*, s 12).

[6.80] Making someone bankrupt

A creditor, or group of creditors, can present a *creditor's petition* to the Federal Court, or more commonly, the Federal Circuit Court to have a person who owes them over \$5,000 made bankrupt.

Why make someone bankrupt?

Sometimes bankruptcy is the only effective way for a creditor to collect all or part of their debt – for example, if the debtor's property is subject to a mortgage or is owned jointly with another person who is not indebted to the creditor.

The threat of bankruptcy

Though a creditor may threaten to make a debtor bankrupt, it is expensive, and the threat is rarely carried out against non-business debtors. Most non-business debtors who become bankrupt do so on their own application.

In any case, a debtor served with a bankruptcy notice (a formal demand which is the first step in the process of making the debtor bankrupt) often either pays the debt or comes to an agreement with the creditor to avoid the consequences of bankruptcy.

Procedure

To make someone bankrupt, a creditor must:

- first obtain a judgment for the debt from a court (see Chapter 15, Debt); then
- prepare a *bankruptcy notice* based on the judgment; then
- submit the notice to the Official Receiver for issue (this can be done online through the Australian Financial Security Authority's website).

The bankruptcy notice is a formal demand that requires the debtor to pay the debt within a set time (usually 21 days).

A debtor who does not either pay or have the court set the bankruptcy notice aside within the time limit commits an *act of bankruptcy*, and the creditor can apply to the Federal Court or Federal Circuit Court to declare them bankrupt by presenting a creditor's petition based on that act of bankruptcy.

If the debtor can satisfy the court that they can pay all debts in a reasonable time, the hearing may be adjourned. If not, the debtor may be made bankrupt.

Sequestration orders

The court order declaring someone bankrupt is called a *sequestration order*. When it is made, the bankrupt's divisible property comes under the control of a private trustee (if nominated by the creditor) or the Official Trustee.

[6.90] Advantages and disadvantages of bankruptcy

Bankruptcy is generally a last resort. It has both advantages and quite serious disadvantages.

Advantages

Release from debts

Once discharged, a bankrupt is released from most provable debts incurred before bankruptcy (see Chapter 15, Debt).

Protection of some property

Most of the person's personal property is protected under s 116(2) of the *Bankruptcy Act* (see [6.130]).

Return of some property

If a bailiff has taken necessary household items to be sold to pay creditors, it may be possible to get them back. If they have been sold, it may be possible to receive the proceeds.

No more harassment by creditors

Bankruptcy should stop harassment by unsecured creditors – all communication takes place between creditors and the bankrupt's trustee (s 58).

Prevention of a garnishee on wages

Bankruptcy stops a garnishee on wages being enforced (see Chapter 15, Debt).

Disadvantages

Public examination of affairs

In complex estates, the trustee can hold a public examination of the bankrupt and/or persons

associated with them before a Federal Court registrar or Federal Circuit Court, requiring the bankrupt to produce any document that may be relevant and answer the trustee's or a creditor's questions on oath, even if the answers are incriminating.

Effect on reputation

The bankruptcy is recorded on the *National Personal Insolvency Index* (NPII) (a permanent record of every bankruptcy since 1928), and may be published in trade journals and local papers.

Need to make payments while bankrupt

A person who is bankrupt must make payments to the trustee from their income while they are bankrupt if they earn over a certain amount.

Problems obtaining credit

Former bankrupts may have trouble obtaining unsecured credit. (Veda, previously Baycorp Advantage Ltd, keeps details of bankruptcies, debt agreements and Pt X agreements for the longer of five years from the date of commencement or two years from the date the arrangement ceases.)

Penalties for non-cooperation

Bankrupts who do not cooperate with trustees or fulfil certain duties (such as notifying earnings), may be punished by the court and/or have the term of their bankruptcy extended to five or eight years (see [6.240]).

Having money and assets taken

Money and valuable goods (with some exceptions) owned or being paid off at the date of bankruptcy, or acquired during bankruptcy, may be taken. For example, if a bankrupt has equity in a house or boat etc but owes money on it through a mortgage, the trustee can sell it and pay the secured creditor under the mortgage. The surplus becomes available for the unsecured creditors.

Restrictions on involvement with a company

Under the *Corporations Act 2001*, a bankrupt cannot be a director, promoter or manager of a company without the permission of the court.

Restrictions in employment

There are restrictions on people in certain types of employment and public office who have been bankrupt, including chartered accountants, barristers, solicitors, security licence holders, tradespeople and justices of the peace.

Restrictions on borrowing

A bankrupt must not borrow or incur a debt of \$5,812 or more without informing the lender or credit provider of their bankruptcy.

[6.100] When does bankruptcy start?

A debtor is considered to have become bankrupt on the first moment of the day on which either their debtor's petition was accepted or a sequestration order was made against them.

[6.110] Insolvent estate of a deceased debtor (Pt XI)

If an insolvent debtor dies leaving insufficient assets to pay their debts, a creditor owed \$5,000 or more may apply for an *order of administration* (*Bankruptcy Act*, s 244). This requires the trustee to distribute the deceased person's assets to pay part, or all, of the debt in accordance with the Act.

The person administering the estate of a deceased person may also seek an order for the administration of the estate in bankruptcy (see Chapter 40, Wills, Estates and Funerals).

Effects of bankruptcy on property

[6.120] Divisible property

A trustee can take certain of a bankrupt's property, in Australia or elsewhere (subject to the law of the country where the property is) (*Bankruptcy Act*, s 116).

Property, the trustee, can take to pay creditors includes:

- the bankrupt's interest in a house;
- cash in the bank;
- jewellery;
- stocks, shares and debentures;
- fixtures and fittings;
- gifts and legacies received under a will;
- crops;
- certain other things.

Certain money owed to the bankrupt can also be recovered by the trustee.

Property available to the trustee to pay creditors is called divisible property.

Sale of assets

The trustee's decisions about what to do with the assets available for sale and distribution among creditors will depend on what they are.

If the assets have little value, the trustee may ask the bankrupt to find a buyer rather than incur the expense that might be involved if the trustee had to find one. The trustee may even be prepared to accept less than market value, where

costs will be saved by not seizing and selling the goods.

Sale to relatives

Where the bankrupt wishes to retain use of the goods, such as a car, a relative may be prepared to make the trustee an offer. Trustees usually cooperate in these circumstances.

[6.130] Property a bankrupt can keep

Property the trustee cannot take is listed in s 116(2) of the *Bankruptcy Act*. Among other things (some of which are discussed below), it includes:

- ordinary clothing;
- necessary household goods (such as TV and video, lounge and kitchen furniture, a domestic refrigerator and washing machine);
- tools of trade if they are to be used to earn income, up to the value of \$3,800;
- most policies of life assurance, endowment assurance, endowment or annuities or the proceeds from such policies;
- amounts paid to the bankrupt under certain rural assistance agreements between the Commonwealth and the states.

The separate property of a non-bankrupt spouse is not affected by the bankruptcy.

Motor vehicles

A bankrupt can keep a vehicle used for personal transport in which they have a net equity of up to

\$8,000. If the equity is more the trustee can sell the vehicle, but must give \$8,000 to the bankrupt from the proceeds so they can buy another vehicle.

Sometimes where the equity is over \$8,000 a vehicle is sold by the trustee to a relative or friend of the bankrupt. If it is security for a finance contract and payments are not kept up, however, the finance company may still seize it.

Money from damages or compensation

The trustee may not take:

- money received as damages or compensation for personal injury or death to the bankrupt or their family; or
- defamation payments; or
- any property (such as a house or car) bought with, or mostly with, that money.

The position with respect to income protection or total and permanent disability payments will depend on the wording of the relevant policy of insurance and it is not possible to state generally whether the proceeds of those payments will vest in the trustee or the bankrupt.

Where property has been paid for partly, but not substantially, with the compensation money (eg, 10% of the price), the bankrupt is entitled to receive that percentage from the proceeds of the sale of that property.

Superannuation

The trustee may not take:

- superannuation policies;
- the person's interest in a superannuation fund;
- lump sum superannuation payments received after the date of bankruptcy; or
- property bought with such money after the date of bankruptcy.

However, the trustee does have power under the *Bankruptcy Act* to recover from a superannuation fund "out of character payments" made into the fund prior to bankruptcy, where it can be shown that the payments were made with the intention of putting those funds beyond the reach of creditors.

[6.140] The bankrupt's home

If a bankrupt owns, or is purchasing, a home, or a couple who are joint owners are both made bankrupt, the trustee normally sells the home if there will be a surplus after paying the mortgage

and sale costs (unless it was bought wholly or substantially with compensation money for an injury – see Money from damages or compensation at [6.130]).

Defence Service homes

If the home is mortgaged to the Defence Service Homes Division, it is protected under the *Defence Service Homes Act 1918* (Cth), and the director of the Defence Department will rarely give permission for a sale.

Joint ownership with a non-bankrupt person

If the home is owned jointly (*joint tenancy*) by the bankrupt and someone who is not bankrupt, the trustee either:

- becomes registered as a tenant-in-common of the home with the non-bankrupt person; or
- lodges a caveat on the title to protect the bankrupt's interest.

Rights of the mortgagee

This does not affect the rights of the mortgagee, and if mortgage payments fall into arrears, the mortgagee can sell the property.

Selling the home

Non-bankrupt joint owners have first option to buy the bankrupt's interest in the home from the trustee. If they cannot afford to do so they may agree with the trustee to sell the home, and receive an equal share of any money left over after the mortgage and costs are paid.

Where the joint owner will not cooperate

If the joint owner will not cooperate, the trustee can apply to the Federal Circuit Court or the Supreme or District Courts (depending on the value of the property) for an order that the property be sold and the proceeds divided.

Where the joint owner claims more than 50%

If the non-bankrupt person considers that they have made a greater than 50% contribution towards the acquisition of the property, they should submit documentary evidence of their claim to the trustee for consideration. However, if the property is jointly owned by a married couple the trustee will generally assert that the "Cummins

Principle” applies; that is, irrespective of unequal contributions to the acquisition of matrimonial property and/or registration in one spouse’s name only and/or borrowings benefiting only one spouse secured against the property, the property is beneficially owned 50/50 (see *Trustees of the Property of John Daniel Cummins v Cummins* [2006] HCA 6). If the trustee does make that assertion then the non-bankrupt person should seek legal advice promptly.

Bankruptcy of one spouse does not stop the other spouse from starting or continuing property settlement and/or maintenance proceedings in the Family Court. The Family Court is now empowered to order a bankruptcy trustee to transfer property in the estate of the bankrupt spouse to the non-bankrupt spouse to satisfy a liability determined by the Family Court in such proceedings.

If the bankrupt has no equity

If the bankrupt has no equity in the property, the trustee will not sell it and the bankrupt can live in it as long as the mortgage and rates are paid. However, the trustee can sell it later when there is equity, even after discharge from bankruptcy.

The trustee may give the bankrupt first option to buy back the equity in the property upon discharge from bankruptcy.

[6.150] Money and goods received

At any time during the bankruptcy, the trustee may take any money (excluding accumulated income) or other items the bankrupt receives, such as gifts, lottery winnings or money received under a will.

If the bankrupt does save up and buys items that are not protected during bankruptcy, these may also be taken by the trustee in certain circumstances (*Bankruptcy Act*, s 58(1)). However, a bankrupt’s accumulated income held in a bank account is protected.

[6.160] Consumer mortgages and bills of sale

Finance companies and other lenders often secure loans with a consumer mortgage or bill of sale over a person’s goods.

If a person becomes bankrupt, and payments are in arrears, the lender can seize the goods and sell them. Money still owed to the lender after the sale is added to the bankrupt’s list of debts.

Exempt goods

Where the mortgage or bill of sale is over goods exempt under the *Bankruptcy Act* (such as household furniture or a motor vehicle worth less than \$8,000 – see [6.130]), the exemption stops the trustee from selling the goods. However, they can still be taken by a lender with a bill of sale or consumer mortgage if the borrower is behind in payments.

The goods cannot be taken by the lender and sold just because the debtor becomes bankrupt. There must be a default under the agreement.

Non-exempt goods

Where the mortgage or bill of sale is over goods that are not exempt under the *Bankruptcy Act*, the trustee may be able to:

- sell the goods;
- pay the lender what is owing on them; and
- keep the balance to pay other creditors.

This is only possible if:

- the lender agrees; and
- the goods are worth more than the amount still owing on them.

Otherwise, the bankrupt can keep them as long as payments are made on time. When they are finally paid for, the trustee can seize and sell them (s 58(1)).

[6.170] Property previously disposed of

Some debtors, seeing the threat of bankruptcy, try to put their property beyond the reach of creditors by transferring it to others, often family members. Property can be reclaimed by the trustee if it was:

- given away or sold in the five years before bankruptcy for less than its full value; or
- given away or sold at any previous time with the intention of defeating creditors (*Bankruptcy Act*, ss 120, 121).

Transfer under a maintenance agreement

Transfers of property under a maintenance agreement before bankruptcy are not affected unless fraud can be established.

Effects of bankruptcy on income

[6.180] While a person is bankrupt, they must make payments to the trustee from their income if they earn over a certain amount.

This threshold income is linked to benefit payments under the *Social Security Act 1991* (Cth). For a person without dependents, the threshold is \$57,866.90 net of tax as at September 2019. The threshold increases if there are dependents.

[6.190] Income contribution

If the bankrupt's assessed income (see Calculating assessed income below) is above the threshold amount, the bankrupt must pay 50 cents in each dollar *above* the threshold (*Bankruptcy Act*, ss 139J–139ZZ). That is, what the bankrupt must pay the trustee for the benefit of creditors (the *income contribution*) is found by subtracting the threshold amount from the bankrupt's assessed income and halving the result.

If assessed income is less than the threshold, no contribution need be paid.

Frequency of payment

The trustee decides how often the contribution is to be paid (weekly, fortnightly or at some other interval).

Bankrupts are encouraged to have the payments directly credited to the trustee's account from either their salary or bank account.

Calculating assessed income

To calculate *assessed income*, the trustee:

- *adds up* the income the person is likely to earn (income includes wages, the value of fringe benefits, rental income, business earnings less expenses, interest, dividends, and periodic payments received from superannuation funds, life policies or trusts);
- *subtracts* income tax paid or likely to be paid;
- *subtracts* child support or maintenance paid or liable to be paid;

- *adds* any amount received or likely to be received in a tax refund.
-

If payments are missed

If payments are missed without satisfactory explanation, the trustee may arrange for the contribution to be garnisheed directly from the bankrupt person's wages.

Hardship

A person suffering hardship can apply in writing to the trustee to reduce the assessed amount. The trustee can reduce the amount if:

- the bankrupt or a dependent has an illness or disability;
- the bankrupt has to pay for childcare to enable them to work;
- the bankrupt is forced to pay high private rent (eg, because they live in a remote area); or
- the bankrupt has substantial travelling costs to get to work.

Appeal

A bankrupt person can appeal to the Inspector-General in Bankruptcy if:

- they disagree with the calculation of their assessed income contribution; or
- they are unhappy with the trustee's response to a hardship application.

If the person is not happy with the Inspector-General's decision, they can appeal to the Administrative Appeals Tribunal.

The assessed contribution must continue to be paid until the appeal has been determined.

Penalty for failing to give information

The maximum penalty for failing to give the trustee information and evidence about income is 12 months' jail.

Obligations, restrictions and rights

[6.200] Obligations and restrictions on bankrupts

Keeping the trustee informed

A bankrupt person is required to keep their trustee fully informed of any change in their:

- name;
- marital status;
- number of dependents;
- residential address;
- employment;
- income.

They must also disclose to the trustee any divisible property they acquire or become entitled to during bankruptcy; for example, an interest in a relative's deceased estate.

Restrictions on credit

A bankrupt person cannot obtain credit for goods or services with a value over \$5,812 without telling the lender they are bankrupt.

Restrictions on overseas travel

A bankrupt person:

- may have to hand over their passport to their trustee if requested to do so;
- cannot travel overseas without the trustee's written permission.

Trustees must follow strict guidelines for authorising overseas travel, and a bankrupt should make their request for the trustee's permission sooner rather than later, to enable the trustee enough time to properly consider the request. Maintaining a positive relationship with the trustee will no doubt improve the bankrupt's prospects of having the trustee approve any request for overseas travel. A person considering bankruptcy who intends to travel overseas while bankrupt should discuss this with their solicitor, accountant or financial counsellor.

If the bankrupt person leaves Australia without the trustee's permission, the period of bankruptcy can be extended to run for eight years, starting from when they re-enter Australia. They can also be prosecuted.

Rights of bankrupts

[6.210] Review of decisions

A bankrupt can ask the Inspector-General to review the decisions of their trustee about income contributions and discharge from bankruptcy. The Administrative Appeals Tribunal can review the decision of the Inspector-General.

The bankrupt can apply to the Federal Court or Federal Circuit Court for a review of any decision made by their trustee. However, the courts will not consider any applications concerning contributions or discharge until the Administrative Appeals Tribunal has considered the matter.

Legal proceedings

A bankrupt person can continue legal proceedings begun before the bankruptcy for personal injury to themselves, or death or personal injury in relation to their spouse or other family members, and also a "wrong done" to the person, such as defamation. Property bought wholly or substantially with compensation or damages received in such proceedings is not available to creditors.

Also, a bankrupt person can continue or start proceedings concerning their employment, such as unfair dismissal or harassment in the workplace.

Any other legal proceedings commenced before bankruptcy are automatically stopped, but if the trustee believes the proceedings have merit, and creditors are willing to fund the action and indemnify the trustee for costs, then the trustee can continue them.

Trustees must act reasonably. They have a duty to consider whether the proceedings have merit and should be continued.

Bank accounts

The person can have a savings account, but most banks need the trustee's consent. There is no limit on the amount of income that a bankrupt can accumulate in their bank account during bankruptcy, however, if the money is withdrawn from the account and used to purchase an asset that is not "protected" (eg, shares) the trustee can take such assets as "after-acquired property".

Travel in Australia

The person can travel freely in Australia, though the trustee must be notified of changes in name, address or employment, including simply using a different name or an additional name.

Right to examine file

The person may examine the trustee's file on their bankruptcy. It will probably contain:

- the trustee's reports;
- copies of relevant court transcripts;
- a list of *proofs of debt* lodged by creditors.

Copies of all relevant documents can be obtained under the *Freedom of Information Act 1982* (Cth) (see Chapter 25, Freedom of Information), though a cheaper option may be to simply ask to look through the file.

Ending bankruptcy

[6.220] Automatic discharge

A person is automatically discharged from bankruptcy three years after filing their statement of affairs unless there is an objection by the trustee (see [6.240]).

Early discharge

Early discharge provisions were repealed as from 5 May 2003.

[6.230] Annulment of bankruptcy

The bankruptcy is annulled when the trustee has, from the sale of divisible property and/or income contributions:

- paid the creditors in full; and
- paid the trustee's fees and expenses.

No court order is needed.

Payment by contributions

A bankrupt who is not required to make income contributions to their trustee can arrange to make payments to creditors that, when completed, will annul the bankruptcy.

The trustee's fees must still be paid before the trustee will grant an annulment.

Part payment

The bankruptcy is annulled if creditors, by special resolution, accept an offer of composition made via the trustee, such as 50 cents in the dollar. There are mechanisms for proposing such arrangements without entering bankruptcy (see [6.50]).

Defects in process

The court may annul a bankruptcy, where it can be established that there was a defect in the legal process that led to the person becoming bankrupt.

Going to court

Under the *Bankruptcy Act*, both the Federal Court and the Federal Circuit Court can hear and decide bankruptcy cases, and either court may alter orders made by it under the Act and may annul a person's bankruptcy.

Appeals from a single judge of the Federal Court are heard by the Full Court of the Federal Court. Appeals from a Federal Circuit Judge are generally heard by a single Federal Court judge.

Legal aid is not available in bankruptcy matters.

[6.240] Extension of bankruptcy

Discharge may be delayed by a further two or five years, making the period of bankruptcy five or eight years, if:

- there are objections to automatic discharge after three years; or
- the bankrupt has not complied with the trustee's directions and/or has failed to cooperate with the trustee in the administration of the bankrupt's estate.

Extension to five years

The period of bankruptcy will be extended to five years if the trustee makes an objection on the grounds that the bankrupt failed to:

- disclose all debts and creditors;
- disclose all property;
- attend an interview with the trustee;

- attend an examination by the court;
- sign documents when asked by the trustee;
- notify the trustee of a change of address; or
- attend a meeting of creditors.

Extension to eight years

The period can be extended to eight years if the trustee objects on the grounds that the bankrupt:

- failed to pay income contributions;
- failed to provide details of property and income to the trustee;
- failed to explain to the trustee how money was spent or assets disposed of;
- borrowed more than \$5,812 without disclosing bankruptcy to the lender;
- left Australia without permission; or
- managed a company while bankrupt.

[6.250] Release from debts

After discharge from bankruptcy (usually three years after filing the statement of affairs), the bankrupt is released from most of their outstanding debts, called *provable* debts.

Victims compensation debts

On discharge, the bankrupt is relieved of any debt created by a provisional order and/or a final determination by NCAT's Administrative and Equal Opportunity Division made before the date of bankruptcy.

Charges for electricity and other services

Accounts for electricity, gas, telephone and so on, unpaid at the date of bankruptcy, are provable debts from which the bankrupt is released. However, the service will probably be disconnected if the person does not pay the bill. A person who wants the service connected at a new address and has a debt to the service provider at the previous address may have to pay a higher security deposit.

Legal advice should be sought if the service provider will not reconnect the service unless arrears incurred before the bankruptcy are paid.

Income tax

Income tax unpaid at the date of bankruptcy (whether or not returns have been lodged or assessments issued) is a provable debt. If any

returns have not been lodged, the bankrupt should lodge them at once to avoid possible prosecution by the Australian Taxation Office (ATO), which is notified of everyone who becomes bankrupt.

The ATO cannot take legal action to recover provable tax debts from a bankrupt, but it has the right to retain refunds from tax returns during the bankruptcy and apply them to tax debts, child support debts and Centrelink debts.

[6.260] Debts from which the person is not released

There are some debts from which the bankrupt person is *not* released.

Child support debts

The creditor (either the bankrupt's former partner or the Child Support Agency) can continue recovery action for child maintenance debts incurred before and during bankruptcy. The bankrupt is only released from liability for interest owing on such debts at the date of bankruptcy.

Bail bonds and court fines

The person is not released from debts arising from bail bonds and court fines. Penalties imposed by way of infringement notices (eg, parking and speeding tickets etc) are provable debts because they have not been imposed by a court and the bankrupt will be released from them on discharge. However, if they are not paid the State Debt Recovery Office (SDRO) will probably suspend the bankrupt's driver's licence and/or vehicle registration until the penalty is paid. If the bankrupt requires their licence for work or other necessity, the SDRO will usually consider an application to lift the suspension if the bankrupt has entered into a repayment agreement with the SDRO.

Proceeds of crime

The person remains liable for pecuniary penalty orders under the federal *Proceeds of Crime Act 1987* (Cth).

Debts incurred through fraud

The person is not released from debts incurred through fraud or a breach of trust, including

money owed to Centrelink or the ATO obtained through fraud or misrepresentation.

Unliquidated claims

Generally, the person is not released from debts arising from unliquidated claims (such as a claim arising from a car accident in which the bankrupt was at least partly at fault) which, although arising from something that happened before the bankruptcy, are not resolved at the date of bankruptcy.

A debtor should finalise such matters before becoming bankrupt.

Debts incurred since entering bankruptcy

The person is liable for any debt incurred since the date of bankruptcy.

Student loans and higher education charges

Loans to students under either the *Student Assistance Act 1973* (Cth) or the youth allowance and Austudy schemes (*Social Security Act 1991* (Cth)) are not provable – a debtor is not released from them on discharge from bankruptcy.

All Higher Education Contribution Scheme (HECS) debts are provable since 7 June 2001, but the person is not released from the HECS debt upon discharge from bankruptcy.

Council rates

Local councils have a *first charge* on real estate when rates are not paid. This means they have a right to take what is owed to them from the proceeds of sale before unsecured creditors are paid.

Contact points

[6.270] If you have a hearing or speech impairment and/or you use a TTY, you can ring any number through the National Relay Service by phoning **133 677** (TTY users, chargeable calls) or **1800 555 677** (TTY users, to call an 1800 number) or **1300 555 727** (Speak and Listen, chargeable calls) or **1800 555 727** (Speak and Listen, to call an 1800 number). For more information, see www.communications.gov.au.

Non-English speakers can contact the Translating and Interpreting Service (TIS National) on **131 450** to use an interpreter over the telephone to ring any number. For more information or to book an interpreter online, see www.tisnational.gov.au.

Changes are expected to the websites for many NSW government departments that were not available at the time of printing. See www.service.nsw.gov.au for further details.

Administrative Appeals Tribunal

www.aat.gov.au

ph: 1800 228 333

Australasian Legal Information Institute (AustLII)

www.austlii.edu.au

Australian Disputes Centre

www.disputescentre.com.au

ph: 9239 0700

Australian Competition and Consumer Commission (ACCC)

www.accc.gov.au

ph: 1300 302 502

Australian Finance Industry Association (AFIA) (formerly known as Australian Finance Conference)

www.afia.asn.au

ph: 9231 5877

Australian Financial Security Authority

www.afsa.gov.au

ph: 1300 364 785

Australian Prudential Regulation Authority (APRA)

www.apra.gov.au

ph: 1300 558 849

Australian Securities and Investments Commission (ASIC)

www.asic.gov.au

ph: 1300 300 630

Australian Taxation Office

www.ato.gov.au

ph: 13 28 65

Certified Practising Accountants Australia

www.cpaaustralia.com.au

ph: 1300 73 73 73

Chartered Accountants Australia and New Zealand

www.charteredaccountantsanz.com

ph: 1300 137 322

Customer Owned Banking Association

www.customerownedbanking.asn.au

ph: 8035 8400

Fair Trading, Office of

Specialist Support Unit

www.fairtrading.nsw.gov.au

ph: 13 22 20

Financial Counsellors Association of NSW (includes a list of accredited financial counsellors in NSW)

www.fcan.com.au

ph: 1300 914 408

Financial Ombudsman Service Australia

www.fos.org.au

ph: 1800 367 287

Financial Planning Association of Australia (FPA)

www.fpa.com.au

ph: 1300 337 301 or 9220 4500

The FPA has a Professional Standards Department. For complaints, see also the Financial Ombudsman Service.

Financial Rights Legal Centre (previously the Consumer Credit Legal Centre)

financialrights.org.au

ph: 9212 4216

National Debt Helpline

ph: 1800 007 007

The Financial Rights Legal Centre deals with matters concerning credit, debt, bankruptcy and banking issues. It does not deal with general consumer issues.

LawAccess NSW

www.lawaccess.nsw.gov.au

ph: 1300 888 529

Legal Aid NSW

www.legalaid.nsw.gov.au

Local Courts: Going to the local court about a debt

www.localcourt.justice.nsw.gov.au

Veda

www.equifax.com.au

ph: 13 83 32

Holds and distributes information on credit ratings and histories.