

***BANKRUPTCY***

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## Case Study

# **BANKRUPTCY**

## **1. INTRODUCTION**

### **1.1 Definition**

Bankruptcy is a legal process by which debtors are separated from most of their unsecured debts; and at the same time the property of the bankrupt other than protected property passes into the ownership of the trustee in bankruptcy.

Bankruptcy normally lasts for three years. During that time, bankrupts have some advantages and disadvantages. Creditors are stopped from taking action for most debts that are a part of the bankruptcy. However, bankrupts cannot travel overseas without their trustee's permission, they must disclose their bankruptcy if they are seeking credit for more than an inflation adjusted figure which is currently \$5,726.00, and they must disclose their bankruptcy if they trade under a name other than their own name, without additions. If bankrupts earn income over an inflated adjusted figure, which is also adjusted to take account of any dependants they have, they are required to make a contribution from income. People considering bankruptcy should check whether bankruptcy may draw attention to conduct which may amount to an offence. The fact that a person becomes bankrupt is recorded on the National Personal Insolvency Index, which is a permanent record. Bankruptcy does have a life-long effect on a person's financial reputation. Some occupations are also affected by bankruptcy. Detail of restrictions are set out later in this paper.

### **1.2 Terms Used in Bankruptcy**

#### **AFSA -**

Australian Financial Security Authority. The Commonwealth government organization which receives debtor's petitions, and administers the estate of

bankrupts. It also administers the Personal Property Securities Register relating to security interests in personal property.

**Annulment -**

Ending of a bankruptcy by it being treated, for most purposes, as if it had never taken place.

**Assets (Property) -**

Anything that is owned by a person, such as land, goods, money, or rights

**Bankrupt -**

A person who has become bankrupt by a debtor's petition, or a creditor's petition, and whose bankruptcy has not yet been annulled or discharged.

**Creditor -**

A person or organization which is owed money, or other property

**Debtor -**

A person or organization which owes money, or other property

**Discharge -**

Ending of a bankruptcy by it being treated as completed. This is normally three years after the bankruptcy began. The debtor ceases to be a bankrupt and is freed from almost all of the obligations of bankruptcy. Assets that passed into the ownership of the trustee in bankruptcy stay in that ownership until disposed of, or

the expiration of six years from the date of discharge if the property was disclosed to the trustee prior to discharge. In the case of property disclosed to the trustee **after** discharge, then the six years runs from the date the bankrupt discloses the property to the trustee. The trustee can give one or more notices extending this time.

### **Divisible Property -**

Property of a bankrupt which is not protected by bankruptcy law and which can be taken by the trustee in bankruptcy and divided amongst creditors.

### **Equity -**

The value of a person's interest in property that exceeds the value of debts attached to that property.

### **Estate -**

The part of the property and financial affairs of a bankrupt dealt with by a trustee in bankruptcy.

### **Liability -**

A legal obligation, to pay money or to do something; a right in another person to take legal proceedings against the debtor.

### **Liquidated Debt -**

A set sum, the agreed or Court-ordered extent of the debtor's liability.



**Provable Debt –**

A debt that is a part of a bankruptcy. Creditors with a provable debt receive a share of any property of the bankrupt that is being divided amongst creditors, and a provable debt is extinguished by the discharge of the bankrupt, unless it is one of a special type.

**Secured Debt –**

A debt that attaches to property. The property can be taken by the creditor if the debt is not paid, without the creditor having to go through the process of suing the debtor, getting a judgement, and then a property (seizure and sale) order.

**Sequestration Order –**

Separation of bankrupts from their divisible property.

**Trustee In Bankruptcy –**

A person or organization to whom the financial affairs and divisible property of a bankrupt are entrusted. In the case of persons who become bankrupt on their own debtor's petition, the trustee in bankruptcy is normally AFSA, unless the bankrupt has substantial assets to be divided. In this case a private trustee is likely to be appointed.

Persons planning to become bankrupt can request a registered trustee to be the trustee of their estates, in the eventuality that they do become bankrupt (156A Bankruptcy Act)

## **Unliquidated Debt –**

A debt that is not a set sum: for example a claim following a motor accident in which the amount of the debt has not yet been set either by agreement between the parties, or by Court order.

## **Unprovable Debt**

A debt that is not legally capable of being part of a bankruptcy. It is outside the bankruptcy, and the creditor can proceed to recover the unprovable debt as if the bankruptcy did not exist. A fine imposed by a Court is not provable in bankruptcy.

## **Bankruptcy Act**

The framework of bankruptcy law in Australia is set out in the Bankruptcy Act 1966. This is a Commonwealth Act of parliament. References to sections of that Act in this note are shown in brackets, for example (s. 55).

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## **2. THE PROCESS OF BANKRUPTCY**

There are two ways a person can become bankrupt.

### **2.1 Debtor's Petition**

One is by the person who wishes to become bankrupt – the debtor – presenting a bankruptcy petition and statement of affairs to AFSA. These forms can be completed electronically and e mailed to [registry@afsa.gov.au](mailto:registry@afsa.gov.au) or posted to

G.P.O. Box 1550 Adelaide S. A. 5001. As noted above debtors can nominate a registered trustee to act for them if they wish, and can pay.

There is no fee on lodging a debtor's petition.

## **2.2 Creditor's Petition**

The second way is that a creditor who wants to make a debtor bankrupt can present a creditor's petition to a Federal Court. Only a creditor owed \$5,000 or more can present a petition (s. 44). The most common way for a creditor to proceed is to sue the debtor, get a final judgement, and then serve a bankruptcy notice on the debtor. If the debtor does not comply with the notice (normally by paying the amount required by the creditor in a specified time) the creditor can then present a creditors petition (ss. 40 (1) (g) and 44 (1) ).

## **2.3 Declaration of Intention to Present a Debtor's Petition**

A debtor who is in urgent need of protection from unsecured creditors can obtain a twenty-one day interval of protection against enforcement process by presenting a declaration of intention to AFSA (s. 54 A). The declaration (Form 5) can be downloaded from the AFSA website mentioned above:

- \* Select options for dealing with unmanageable debt from Welcome to AFSA screen;
- \* Under What are my options for dealing with unmanageable debts? Select:  
Formal options under the Bankruptcy Act  
Declaration of intention to present a debtor's petition (DOI).

On the screen What is a declaration of Intention to prevent a debtor's petition? (DOI), select the last option:

I want to lodge a DOI. From this you can download the forms, and under Send us a document, get instructions for sending it to AFSA.

A person is disqualified from presenting a declaration of intention if:

- \* they are not eligible to present a debtor's petition – see below;
- \* a creditor's petition has been presented against them, and is not resolved;
- \* they have presented a debtor's petition which has not been accepted or rejected;
- \* they are in a Part X agreement, or in a process leading to one;
- \* they have successfully presented a declaration of intention in the preceding twelve months (s. 54B)

If the declaration of intention is accepted, AFSA notifies creditors which are listed on the Form 5 completed by the debtor (s. 54 C).

During the twenty-one day stay period, creditors and the Sheriff are prevented from taking enforcement action against the debtor. However, creditors are not prevented from taking other legal action against the debtor: For example, a creditor can continue with a creditor's petition (s. 54 E and F).

The declaration of intention does not stop secured creditors from enforcing their security (s. 54 L). A Declaration of Intention is not recorded in the National Personal Insolvency Index (Regulation 13.03).

## **2.4 Eligibility to Present a Debtor's Petition**

To be eligible to present a debtor's petition in bankruptcy a person must have a certain degree of connection with Australia. The debtor must be in at least one of these categories;

- a) was personally present or ordinarily resident in Australia; or
- b) had a dwelling-house or place of business in Australia; or
- c) was carrying on business in Australia, either personally or by means of an agent or manager: or
- d) was a member of a firm or partnership carrying on business in Australia by means of a partner or partners or of an agent or manager: (s 55 (2A) ).

## 2.5 AFSA's Discretion to Reject a Debtor's Petition

AFSA can reject a debtor's petition if it appears that the debtor could, either immediately or in a reasonable time, pay the debts

### And Either

- if it appears the debtor is unwilling to pay one or more debt to a particular creditor or creditors, OR
- the debtor has been bankrupt at least three times before on a debtor's petition, or at least once in the preceding five years: (s. 55 ( 3AA) ).

Debtors who are under 18 years can present a debtor's petition (s. 7 (1A) as can debtors who are not Australian citizens ( s 7 (1) ). A person who is 'of unsound mind' can become bankrupt if a person authorized by law presents a petition on their behalf: s 308 (c) ). An example of a person authorized by law is a person with an administration order or guardianship order under the Guardianship and Administration Act 1990 (W.A.). However section 308 does not permit a person with a power of attorney to present a debtor's petition on behalf of the donor of the power: Orix Australia Corp. Ltd v McCormick [2005] FCA 1032.

### 3. EFFECTS OF BANKRUPTCY

#### 3.1 Vesting of Property

When a person becomes bankrupt, some of their property passes into the ownership of the trustee in bankruptcy. Some of the property which a bankrupt acquires during the term of the bankruptcy also passes into the ownership of the trustee. This property which passes into the ownership of the trustee is described as 'divisible property' because it can be divided amongst the creditors: (s. 58). The income of a bankrupt is not viewed as property, and accordingly does not pass into the ownership of the trustee. Depending upon their income, and number of dependants, bankrupts may be liable to make contributions from income during the time they are bankrupt: (s. 139 P).

#### 3.2 What is Property?

The word property is usually thought of as referring to things, like houses and cars. Property also includes rights like an entitlement to claims in a deceased estate and windfalls like a lottery win.

#### 3.3 After Acquired Property

After acquired property is any property acquired by the bankrupt after the date of the bankruptcy but before discharge.

#### 3.4 Protected Property

When a person becomes bankrupt, some of their property does not pass into the ownership of the trustee in bankruptcy. This property is **non-divisible**, and protected. The same categories of property are protected if a bankrupt acquires

them during the time they are bankrupt: (s. 58 (1) and s. 5 definition of “the property of the bankrupt”).

### **3.5 Types of Protected Property**

#### **3.5.1 Property Held in Trust**

Property held by the bankrupt in trust for another person is protected in bankruptcy: ( s.116 (2) (a) ). This relates to the situation in which the bankrupt is the trustee, that is, the person holding the property for another person who is called the beneficiary. The trust need not be a formally created one, provided that it is reasonably able to be proved. For example, if a parent has created a trust account in the name of the parent and child, the money from the trust account has always been applied for the child’s benefit, and not mixed with the parent’s other money, or used for the parent’s benefit, then there are good grounds for arguing that it is held on trust for the child.

This protection in bankruptcy does not include the situation in which the bankrupt is the **beneficiary** of a trust. A person setting up a trust for a number of people, some of whom may conceivably become bankrupt in the future, may choose to make the trust discretionary. This means that if some beneficiaries become bankrupt in the future, the trustees can exercise their discretion and not give anything to those beneficiaries while they are bankrupt.

If a person considering bankruptcy thinks it likely that a parent, other family member, or another person may die and leave them something of value in their will, they can suggest to the parent or other possible benefactor that they change their wills so that the interest of the person becoming bankrupt is only that of a discretionary beneficiary. The trustee of the trust can decide not to give anything to that person while they are bankrupt, but can give money or property to that person after they are discharged from bankruptcy.

### 3.5.2 Household Property

West Australian state debt collection laws protect a limited range of property while bankruptcy protects most of the household property found in average homes: (s.116 (2) (b) – compare with Civil Judgments Enforcement Regulations 2005, Regulation 35.)

The general principle in bankruptcy is that household property including recreational and sports equipment, that is reasonably necessary for the domestic use of the bankrupt's household, having regard to current social standards, is protected.

#### **Protected Items Include:**

- \* Kitchen equipment, cutlery, crockery, foodstuffs, heating equipment, cooling equipment, telephone equipment, fire detectors and extinguishers, anti-burglar devices, bedding, linen, towels and other household effects which are reasonably appropriate for the household in the light of the make-up and circumstances of the bankrupt's household.
- \* sufficient household furniture
- \* educational, sporting or recreation items including books that are wholly or mainly for the use of children or students in the household.
- \* one television set
- \* one set of stereo equipment
- \* one video
- \* one radio
- \* either – one washing machine and one clothes drier OR one combined washing machine and clothes drier



- \* either – one refrigerator and one freezer OR one combination refrigerator-freezer
- \* one generator, if relied on to supply electrical power to the household
- \* one telephone appliance
- \* sentimental property: some types of property which are of sentimental significance to a bankrupt such as sporting, cultural, military or academic awards which are identified by a special resolution passed by the creditors may be kept by the bankrupt even though they would otherwise vest in the trustee and be sold. (Bankruptcy Regulations 6.03 and 6.03A)

### **3.5.3 Property For Earning Income by Personal Exertion (formerly tools of trade)**

Protected to the value of \$3,750 (inflation adjusted): (s. 116 (2) (c) ).

### **3.5.4 Means of Transport**

Property used by the bankrupt primarily as a means of transport is protected to the wholesale value of \$7,900. (inflation adjusted) (s. 116 (2) (ca) ).

### **3.5.5 Life Assurance**

Life assurance and endowment assurance on the life of the bankrupt, or the bankrupt's spouse, or de facto partner and the proceeds of such policies received **on or after** the date of bankruptcy: (s. 116 (2) (d) ).

### **3.5.6 Superannuation**

The interest of the bankrupt in a regulated superannuation fund, and a payment

(other than a pension) to a bankrupt from such a fund received **on or after** the date of the bankruptcy is protected. A lump sum received **before** bankruptcy is not protected: (s. 116 (2) (d) (iii) and (iv) ).

### **3.5.7 Damages and Compensation**

The right of a bankrupt to recover damages or compensation for personal injury or wrong done to the bankrupt or a member of the bankrupt's family, or the death of such a person, or any damages or compensation recovered before or after becoming bankrupt: (s. 116 (2) (g) ).

### **3.5.8 Rural Support Schemes**

Some monies paid to a bankrupt under a rural support scheme are protected, but some payments made under more recently established schemes are not. Subsections 116 (2) (k) to 116 (2) (ma) include as protected property money paid to a bankrupt under a rural support scheme prescribed for the purposes of those subparagraphs. Bankruptcy regulations 6.04 A and 6.04 B list certain schemes to which protection extends. Payments made under other schemes, for example an Exceptional Circumstances Exit Package which is not listed, are not protected. If a payment to a farmer is protected under these provisions, the protected status follows the money into investment in other sorts of property, and if a piece of property is purchased partly with protected money and partly with other money then the piece of property concerned is protected property to the proportion of its value which represents the amount of protected money put towards its purchase. In other words, a percentage calculation is applied to the initial purchase, and the later value.

### **3.5.9 Investments of Protected Property**

If protected money – that is, money in a protected category listed above (life assurance, superannuation, damages or compensation or Rural Support Schemes payments) is used to buy a piece of property, that piece of property is also protected to the extent the money was. If only a portion of the money used to buy property is protected money, only a similar portion of the property's value is protected: (s.116 (2) (n) ).

If a bailiff or sheriff has seized some of the debtor's property but has not sold it, it is returned to the debtor if he or she becomes bankrupt: (s. 58 (3) ).

### **3.5.10 Property Transferred by Bankrupts Trustee under Family Court Order**

Following recent amendments to the Bankruptcy Act relating to the integration of bankruptcy and family law, there is a new category of protected property. This is property which due to an order under the Family Law Act the trustee in bankruptcy is required to transfer to the spouse or former spouse of the bankrupt: (s. 116 (2) (q) ).

### **3.5.11 Dealing With Equity In A Property**

The fact that non-protected property vests in the trustee at the time the person becomes bankrupt means that all houses, land, and most business equipment, pass into the ownership of the trustee. Because sub section 58 (5) provides that this process does not affect the right of a secured creditor to deal with its security, the rights that the trustee has in regard to this property comes subject to any mortgage or other debt secured on it.

### **3.5.12 Equity in Vehicles and Other Chattels**

If property is less valuable than the amount of money secured on it (which is the case with many vehicles) then it is unlikely that the trustee will be interested in that property. If the bankrupt is able to go on making the payments required under the loan which is secured on that vehicle the bankrupt can keep that vehicle despite being bankrupt. Section 302 of the Bankruptcy Act provides that any provision in a mortgage, PPSA security agreement or similar document that the creditor is entitled to repossess the property just because the person has become bankrupt is void. It is useful for bankrupts to know that if they keep up the payments on the secured goods and otherwise comply with the contract (for example by making sure that the property is insured) they can keep that property and continue to use it despite being bankrupt.

Property of this nature normally decreases in value as time goes by. Accordingly, it is usual that the property is valued at the start of the bankruptcy, and if it is less valuable than the amount of money secured on it, the trustee takes no further interest in it.

### **3.5.13 Real Estate**

If a person becoming bankrupt owns land or a house, and there is no debt secured on it, or the secured debt is significantly less than the value of the property, the trustee in bankruptcy will take the property, sell it, pay out the secured debt, and put the surplus into the bankrupt's estate.

If a person becoming bankrupt owns land or a house on which is secured debt of a similar amount, or greater, than its value the current practice followed by AFSA is that a caveat is placed on the title at the beginning of the bankruptcy, and the position reviewed at the end of the bankruptcy. If the equity is still small, or

negative, the trustee may sell the equity to the bankrupt or a person introduced by the bankrupt.

It is important to note that if the trustee sells the equity in real estate in Western Australia to the bankrupt or another person, duty is payable on the unencumbered value of the property transferred. The duty is payable by the person to whom the property is transferred.

As set out below, a trustee in bankruptcy has up to six years after the bankrupt is discharged (at the end of the bankruptcy) to make a claim to property disclosed by the bankrupt in the statement of affairs.

If there is a very large equity in the property and the bankrupt is not able to raise from family and friends money sufficient to buy the equity from the trustee, then it is inevitable that the property will be sold, and the proceeds dealt with in the way mentioned above.

Bankrupts who are continuing to occupy property which has vested in the trustee in bankruptcy need to be aware that they will have to go on making all payments falling due upon the property, for example rates, water rates, insurance etc. as well as mortgage payments. They need also to be aware that because the property has vested in the trustee, they do not own it anymore, even if they make mortgage payments on it.

#### **3.5.14 Time Limit on Trustee for Realising Property**

Previously, a trustee had twenty years to make a claim on the property of a bankrupt (s.127 (1) ). This provision remains, but there is a new provision added to it that creates a six year time limit after discharge for trustees to assert a claim to property (other than cash) **which the bankrupt has disclosed in a**

**statement of affairs, or in the case of after acquired property, within fourteen days of its acquisition (s. 129 AA (1) ).**

If a bankrupt notifies a trustee of after-acquired property after discharge, the six year time limit runs from the date of disclosure (s. 129 AA (3) (c) ). However, these provisions are subject to the possibility of the trustee giving the bankrupt an extension notice before the end of the six years. (s. 129 AA (4)), and there is no limit on the number of extension notices a trustee may give (s 129 AA (5)). This would seem to create an inconsistency on the face of the legislation between section 127 which places a twenty-year time limit on action by the trustee to claim property, and section 129 AA (4) and (5), under which a series of extension notices could extend beyond twenty years. As the intention is presumably to make trustees act within six years to claim property, this indefinite extension seems out of place. As with the new provisions noted above relating to objections to discharge, this provision emphasizes the importance for all bankrupts to be full and prompt in disclosure to their trustees.

### **3.5.15 Tax Refunds**

Because the income of a bankrupt is not property that vests in the trustee, a tax refund which is a part of the bankrupt's income does not vest in the trustee. Tax refunds on a bankrupt's income earned during the time the person is bankrupt are added to the bankrupt's income to see if they are liable to make a contribution from income. (s. 139 N (1) (b) ).

However, if a bankrupt receives a tax refund that relates to a period of time before the bankruptcy, then that income was not income of a bankrupt and so is not protected: (s. 139 N (2) ). A tax refund received by a bankrupt which relates to income earned before the bankruptcy vests in the trustee in bankruptcy as after acquired property. If a tax refund relates partly to income earned before

the bankruptcy and partly to income earned after the bankruptcy, then the refund is divided up in proportion to the time before and after bankruptcy: (s. 139 N (3) ).

#### **4. PROVABLE DEBTS**

The general principle set out in section 82 of the Bankruptcy Act is that all debts and liabilities which the bankrupt has at the date of becoming bankrupt are provable in the bankruptcy. This means that they are a part of the bankruptcy. The terms 'debts and liabilities' includes debts from all parts of the world. Five types of debt which are provable in bankruptcy, but which sometimes cause doubt are tax debts, restitution, criminal injuries compensation, child maintenance and child support debts, and unliquidated debts of a contractual nature.

##### **4.1 Tax Debts**

Debts owing to the Australian Taxation Office, be they for ordinary tax or GST, are provable debts. Accordingly they must be shown in the Statement of Affairs. However it is important to point out to clients who owe GST that they should make efforts to pay that before they become bankrupt. While the GST is a provable debt, it is an offence to collect money for ATO for GST, and fail to remit it. Accordingly a person may be prosecuted for failing to pass on the GST even if they are bankrupt. The same principle applies to monies withheld by employers from their employees wages.

It is also an offence to fail to submit tax returns, and BAS when they are due. Clients should make an effort to have all returns up to date at the time of becoming bankrupt.

## 4.2 Restitution

A restitution order is an order directing a person at fault in some way to restore to their former position a person who has suffered a loss as a consequence of the wrongdoing. An example is that an employee who is convicted of stealing from an employer may be ordered to pay a fine, for example \$10,000, and to make restitution of the loss to the employer in the amount of \$12,345. In that example, the fine of \$10,000 **is not** a provable debt (s. 82 (3) ), but the restitution of \$12,345 **is** provable in bankruptcy (s. 82 (1) ). The key concept with restitution being a provable debt is that it is a debt in regard to which the creditor could sue and get a judgment against the debtor. If the debtor became bankrupt, the creditor could make a claim in the bankruptcy for that amount – in this example, for \$12,345.

The reason for section 82 being so all-encompassing is to ensure that a particular creditor (in this example, the employer who is owed \$12,345) does not have an unfair advantage over other creditors in the bankruptcy. (Storey v Lane (1981) 147 CLR 549 at 555 – 556 per Gibbs C.J.) It is a fundamental principle in bankruptcy that all creditors should rank equally in seeking a share of any money or property of the bankrupt which may be available to be distributed, and at the same time the bankrupt is freed of liability attaching to those debts. (Official Trustee In Bankruptcy v C.S. and G. H. Handby Pty. Ltd. 1989 21 FCR 19 at 24).

## 4.3 Criminal Injuries Compensation

A person who suffers injury as a result of a criminal offence may seek compensation under the Criminal Injuries Compensation Act 2003. A claim is made to the Criminal Injuries Compensation Department of the Attorney General (9425 3250) which may make an order for compensation. The offender may be ordered by the Assessor to pay to the government an amount equivalent to the



award to the injured person. Because any such order is made by the Assessor, it is not a penalty or fine imposed by a court, and does not come within the exception in subsection 82 (3) of the Bankruptcy Act. Accordingly, an award of criminal injuries compensation **is** a debt provable in bankruptcy, and so after the offender has become bankrupt the creditor (the State Government) cannot enforce any remedy in regard to the non-payment of the criminal injuries compensation against the person or property of the offender (s. 58 (3) (a) ).

#### **4.4 Child Maintenance and Child Support**

Orders, assessments and agreements about child support or maintenance have a special status in bankruptcy. They are provable debts, (s. 82 (1A)) however bankruptcy **does not** prevent a maintenance creditor (which includes the Child Support Agency) enforcing a remedy against the person, income or property of a bankrupt (s. 58 (5A)). At the end of a bankruptcy a bankrupt does not get a discharge from a maintenance debt unless a Court specifically orders this. (s. 153 (2) (c) ).

The provisions in the Bankruptcy Act use the terms 'maintenance agreement' and 'maintenance order'. These terms are defined to include maintenance agreements registered in a court, an order of a court relating to maintenance or arrears of maintenance, and an assessment under the Child Support (Assessment) Act. However, the definition excludes a financial agreement: (s. 5).

#### **4.5 Late Payment Penalties**

Though the definition 'maintenance order' includes an assessment under the Child Support (Assessment) Act (s. 5) it does not include late payment penalties imposed on late payments of child support. The reason for this is that late payment penalties are imposed by section 67 of the Child Support (Registration and Collection) Act 1988. Because a liability under this Act is not part of the

definition of 'maintenance agreement' or 'maintenance order' in the Bankruptcy Act, all the provisions of that Act giving a special status to child support assessments do not apply to child support late payment penalties. The effect of this is that child support late payment penalties accrued prior to the bankruptcy are a provable debt. Bankruptcy prevents the Child Support Agency pursuing the debtor for them, and the debtor gets a discharge from them at the time of discharge from bankruptcy.

The definition of provable debts includes a debt under a maintenance agreement or a maintenance order, that is, this type of debt is part of the bankruptcy: (s. 82 (1A) ). This means that if there is property or income to be shared amongst the creditors, the maintenance creditor (including the Child Support Agency) takes a share along with other creditors.

The general rule is that bankruptcy prevents a creditor with a provable debt from enforcing any remedy against the person or the property of the debtor: (s.58 (3)). This general rule does not extend to a maintenance creditor. Despite bankruptcy, a maintenance creditor including the Child Support Agency can enforce a remedy against the person, income, or property of a bankrupt that is not vested in the trustee in bankruptcy: (s. 58 (5A)).

In assessing the liability of a bankrupt to make a contribution from income, the bankrupt's income is taken to be reduced by the income tax the bankrupt is obliged to pay, and the maintenance or child support the bankrupt is liable to pay: (s. 139N (1)).

When a person is discharged from bankruptcy, the discharge does not release any debt under a maintenance order or agreement, unless a Court specifically orders in such terms: (s. 153 (2) (c) and (2A)). As noted above, the bankrupt does obtain a discharge from late payment penalties which accrued before the bankruptcy.

#### **4.6 Unliquidated Claims of a Contractual Nature**

A demand for unliquidated damages for **tort** is not provable in bankruptcy: (s. 82 (2)). An example is a claim for damages for negligence following a motor accident. A person with such a liability who is contemplating bankruptcy will wisely arrange to ensure the liability is liquidated, or crystallized, either by ensuring the precise amount is agreed between the parties, or set by a court order.

However, unliquidated damages of a **contractual** nature are provable in bankruptcy: (s 82 (2)). An example of unliquidated damages of a contractual nature is the liability of a debtor under a contract for a loan secured on a motor vehicle. If the debtor is behind in payments, and expects the vehicle will be repossessed, the debtor does not know how much is owing until the lender repossesses the vehicle, sells it, and then does the necessary calculations. Despite the uncertainty of the amount of the liability, if the debtor becomes bankrupt before the vehicle is repossessed or sold, the debt is still provable even though its exact amount is unknown. A debtor becoming bankrupt in those circumstances estimates the liability, and puts the estimate in the Statement of Affairs.

#### **5. NON PROVABLE DEBTS**

As mentioned above in regard to provable debts, the general principle is that all debts and liabilities which a person has at the time they become bankrupt are provable in bankruptcy – that is, they are a part of the bankruptcy. It is only if a particular liability is made non provable by a particular provision in the Bankruptcy Act, or some other Act, that it is not provable. The starting point is clearly to assume all liabilities are provable, unless they fall into one of the exceptions.

The exceptions are:

### **5.1 Unliquidated Damages for Tort**

As noted above, unliquidated damages for tort are not provable in bankruptcy: s 82 (2). This is an example of the words used in 82 (2), which are 'demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise or breach of trust are not provable in bankruptcy'. This means that claims for unliquidated damages for breach of a contract **are** provable in bankruptcy, but claims for unliquidated damages for an actionable wrong, or tort, **are not** provable in bankruptcy.

If a person has had a motor accident, and is considering bankruptcy, it is vital to ensure the claim against them is liquidated or made into a set sum either by court order, or by correspondence back and forth between the parties agreeing upon a particular sum of money as the damages. If there are court proceedings, it is necessary to wait until the court proceedings are completed, a final judgment made by the court, and any costs order is made.

Unless a costs order is made before the debtor becomes bankrupt, it does not constitute a provable debt in the bankruptcy: *Foots v Southern Cross Mine Management Pty. Ltd.* 2007 234 CLR 52.

### **5.2 Penalties or Fines Imposed By a Court**

Penalties or fines imposed by a court in respect of an offence against a law are not provable in bankruptcy: s. 82 (3). The important thing to note are the words 'imposed by a court'. As noted above, the Assessor of Criminal Injuries is not a court, and accordingly an assessment of criminal injuries compensation against an offender **is** provable in bankruptcy.

### 5.3 The Mansfield Decision

More difficult questions arise with a parking fine imposed by a local council. At first glance, one would expect this to be a provable debt, because the parking inspector and the council are not courts. However in the case State of Victoria v Mansfield (2003) 130 FCR 376 a parking fine was held to be a penalty or fine within the meaning of subsection 82 (3) due to the structure of the PERIN system in Victoria. In Victoria, an infringement penalty is registered in the Magistrates Court, and a registrar of that Court makes an enforcement order, which is deemed by the legislation to be an order of the Court. The structure of the West Australian fines enforcement system differs in some ways, however until the matter is judicially explored, it is prudent to view penalties and infringement notices under the Fines, Penalties and Infringement Notices Enforcement Act (1994) (WA) as **not provable** in bankruptcy. A client contemplating bankruptcy would wisely pay penalties and infringement notices, and not rely on bankruptcy as a shield.

### 5.4 1317G Corporations Act

An amount payable under section 1317G of the Corporations Act 2001 (Commonwealth) is not provable in bankruptcy: s. 82 (3AA). Section 1317G provides a court can make pecuniary penalty orders relating to contraventions of the Corporations Act concerning corporations, schemes, and financial services.

### 5.5 Higher Education Debts

A debt incurred under part 4 – 1 of the Higher Education Support Act 2003 (HES Act) is not provable in bankruptcy. These are of five types.

A HECS-HELP debt is a loan by the Commonwealth to a student to pay a student contribution amount for a unit of study.

A FEE-HELP debt is a loan by the Commonwealth to a student to pay a tuition fee for a unit of study.

An OS-HELP debt is a loan by the Commonwealth paid by a higher education provider to the student.

An SA-HELP debt is a loan by the Commonwealth for payment of services and amenities fee.

VET FEE-HELP debt is a loan by the Commonwealth to a student for a VET tuition fee for a VET unit of study. "VET" stands for vocational education and training.

These five types of HELP debt are discharged by death, (HES Act s. 137-20) but are not provable in bankruptcy. (s. 82 (3AB)).

Section 12 ZW of the Student Assistance Act 1973 (Commonwealth) provides that a debt under a student's financial supplement contract is **not** provable in bankruptcy. These contracts related to loans from 'participating corporations' to students which a student could choose to receive instead of the normal student payments. Section 12 ZW applies also to Part X personal insolvency agreements, but **does not** apply to debt agreements (12 ZW (2)).

## **5.6 Proceeds of Crime Debts**

Amounts payable under orders made under the Proceeds of Crime Act 1987 (Commonwealth), the Proceeds of Crime Act 2002 (Commonwealth), or a corresponding law of a state or territory are **not** provable in bankruptcy: s. 82 (3A). In Western Australia the corresponding law is the Criminal Property Confiscation Act 2000.

## **5.7 Interest on Provable Debts**

Interest accruing on a debt after a person becomes bankrupt is not provable in the bankruptcy. The practical effect of this is the amount of debts is set or frozen at the beginning of the bankruptcy: (s. 82 (3B)).

## **6. DISCHARGE AND ANNULMENT**

### **6.1 What is Discharge?**

At the end of a bankruptcy, normally at the expiration of three years from the date the person became bankrupt, the person obtains a discharge from bankruptcy. This means that the person is no longer a bankrupt, but also that most of the debts which were a part of the bankruptcy, that is debts provable in the bankruptcy, are extinguished: s.153 (1)).

### **6.2 What Is Annulment?**

Annulment is an end to bankruptcy, after which a person is deemed, for most purposes, never to have been bankrupt. Some people may find this preferable for their future financial standing. There are three ways in which bankruptcy can be annulled. These are:

- \* a composition or arrangement with creditors after bankruptcy: s. 73
- \* annulment by payment in full of the debts: s. 153A, and
- \* annulment by a Court on the basis that the bankruptcy should not have occurred: s.153B

### **6.3 Abolition of Early Discharge**

If a person became bankrupt before 5 May 2003 it was possible to apply for an early discharge, in certain circumstances. Persons becoming bankrupt on or

after 5 May 2003 are not eligible for early discharge. Their bankruptcy will run for three years unless it is extended in accordance with the provisions set out below under 'Objections to Discharge'.

#### **6.4 Secured Debts Discharged Too**

Bankruptcy does not affect the right of a secured creditor to levy on or deal with its security (s. 58 (5) ). For example, the fact that a borrower has become bankrupt does not prevent a lender, which has a secured interest in the vehicle, from repossessing the vehicle and selling it, if the borrower does not keep up the payments. However, bankruptcy does free the borrower from action for any shortfall that may remain after the vehicle has been sold. (s.153 (1) ). This principle is particularly important for a borrower left with a large shortfall on a mortgage, if a house has been taken by the lender and sold. If the borrower does not become bankrupt, a mortgage creditor has up to twelve years to sue for the principal of a debt – (Limitation Act 2005 s. 20 WA).

#### **6.5 Exceptions to Discharge**

##### **6.5.1 Bail Bond or Recognizance**

Discharge does not free the bankrupt from a debt on a recognizance or a bail bond. This sort of debt arises when a bankrupt signs a recognizance, or bail bond, which is intended to ensure that a person charged with a criminal offence appears in court on the due day. (s. 153 (2) (a) ).



### **6.5.2 Unpaid Income Contributions**

If a bankrupt is required to pay a contribution from income, and at the time the bankrupt is discharged there are arrears, the liability for these unpaid contributions continues despite discharge. (s. 153 (2) (aa) ).

### **6.5.3 Debts Incurred By Fraud**

Discharge does not release the bankrupt from a debt incurred by a fraud to which the bankrupt was a party: that is, a fraud in which the bankrupt played a part (s. 153 (2) (b)). Fraud in this context includes a fraudulent breach of trust to which the bankrupt was a party, or a bankrupt fraudulently obtaining forbearance in regard to a debt. In this context forbearance means refraining from suing or pursuing the debt. This should be borne in mind by a debtor who tries to deflect the creditors' pursuit of them by dishonest means. However, fraud does not include oversight by a creditor which causes a debt to occur. This is important in the context of a Centrelink debt.

### **6.5.4 Centrelink Debts and Bankruptcy**

If a person has incurred a debt to Centrelink by fraudulent activity, and then becomes bankrupt, bankruptcy operates in regard to that debt like all other provable debts. However the fact that the debt is a debt incurred by fraud means that it fits into one of the exceptions to discharge mentioned above, and accordingly after the person is discharged from bankruptcy Centrelink can again pursue the person for that fraudulently incurred debt.

### **6.5.5 Maintenance and Child Support Debt**

As mentioned above, these debts are provable in bankruptcy, (s. 82 (1A)) but the bankrupt does not ordinarily get a discharge from them at the end of the

bankruptcy (s. 153 (2) (c)). This means that a maintenance creditor is in an unusually privileged position. If there are any assets to vest in the trustee or contributions from income paid to the trustee the maintenance creditor (which includes the Child Support Agency) is able to lodge proof of debt and obtain a payment from the bankrupt estate of a proportionate share of the money being distributed to creditors. However at the end of the bankruptcy the debt is not discharged and the maintenance creditor can continue to pursue the debtor for any outstanding money despite discharge. It is also open to a maintenance creditor to pursue a maintenance debtor during bankruptcy (s. 58 (5A)). The effect of this is that bankruptcy is of little value to a person who owes money for maintenance or child support, except insofar as being freed from other debts will give them a greater opportunity to pay the maintenance or child support debt. One benefit of bankruptcy to a child support debtor is that late payment penalties imposed by the Child Support Agency are provable in bankruptcy and are discharged at the end of bankruptcy. (See Late Payment Penalties above).

#### **6.5.6 HECS Debt and Discharge**

HECS debts arise under the Higher Education Funding Act 1988 (Commonwealth) – the HEF Act. If a person has an accumulated HECS debt or an unpaid semester debt at the time they become bankrupt, those debts are provable in bankruptcy: (HEF Act s. 106 YA (2)), however the person does not get a discharge from those debts when they are discharged from the other debts: (HEF Act s. 106 YA (5)). A HECS assessment debt arises when the person's income reaches a particular level, and their taxation assessment includes a portion of the HECS debt, called the HECS assessment debt. This amount is payable along with other tax owing. If the person becomes bankrupt, their HECS assessment debt is provable, and they do get a discharge from it at the end of the bankruptcy.

The HECS scheme was modified, and become HECS-HELP with effect from 1 January 2005. See Higher Education Debts above.

## **6.6 Objections To Discharge**

There are some situations in which a trustee may object to the bankrupt's automatic discharge at the end of three years. These are generally situations in which the bankrupt has been dishonest or unco-operative. The bankruptcy can be extended to a total duration of five or eight years.

### **6.6.1 Grounds Of Objection Which May Extend A Bankruptcy to Five Years Duration Are:**

- \* the bankrupt has left Australia and has not returned to Australia: s. 149 D (1) (a)
- \* any transfer is void as against the trustee in bankruptcy because it was an undervalued transaction (s.120) or a preference to a creditor: s. 122: S 149 D (1) (aa).
- \* the bankrupt took part in the management of a corporation: s: 149 (D) (1) (b)
- \* the bankrupt engaged in misleading conduct in respect of an amount in excess of \$5,726: s.149 D (1) (c) - (inflation adjusted)
- \* the bankrupt has failed intentionally or otherwise to disclose a liability to the trustee: s. 149 D (1) (i)
- \* the bankrupt has failed to disclose a material change occurring between the time the bankrupt lodged a statement of affairs and the time the

bankrupt become bankrupt, or a material change occurring later, or a change in the bankrupts name or address: s. 149 D (1) (j)

- \* the bankrupt failed to attend a meeting of creditors without approval or explanation: s. 149 D (1) (l)
- \* the bankrupt failed to attend an interview or examination without a reasonable explanation: s. 149 D (1) (m)
- \* the bankrupt failed intentionally or otherwise to disclose to the trustee the bankrupt beneficial interest in any property: s. 149 D (1) (n)

#### **6.6.2 Grounds Of Objection Which May Extend A Bankruptcy To Eight Years Duration Are:**

- \* the bankrupt has made a transfer of property with an intention to defeat or delay creditors: s 121: s 149 D (1) (a b)
- \* the bankrupt makes a contribution to a superannuation fund with intention to defeat or delay creditors: s. 128B and s. 149D (1) (ac)
- \* a third person makes a contribution to a superannuation fund with intent to benefit the bankrupt and to defeat or delay creditors: s. 128C and s. 149 D (1) (ad)).
- \* the bankrupt fails to provide written information about the bankrupt's property, income or expected income when requested in writing by the trustee to do so: s. 149 D (1) (d)
- \* the bankrupt intentionally provided false or misleading information to the trustee: s. 149 D (d a )

- \* the bankrupt failed to disclose particulars of income or expected income: s. 149 D (1) (e)
- \* the bankrupt failed to pay to the trustee an amount that the bankrupt was liable to pay as a contribution from income: s. 149 D (1) (f)
- \* the bankrupt during the bankruptcy or within the five years preceding it spent money but failed to explain adequately to the trustee the purpose for which the money was spent, or disposed of property but failed to explain adequately to the trustee where the money is: s. 149 S (1) (g)
- \* the bankrupt failed to return to Australia when requested to do so by the trustee: s. 149 D (1) (h)
- \* the bankrupt intentionally failed to disclose to the trustee a liability of the bankrupt: s. 149 D (1) (h a)
- \* the bankrupt failed to give their passport to the trustee forthwith after becoming bankrupt: s. 149D (1) (ia) and s. 77 (1) (a) (ii).
- \* the bankrupt refused or failed to sign a document after being lawfully required by the trustee to do so: s. 149 D (1) (k)
- \* the bankrupt intentionally failed to disclose to the trustee the bankrupt's beneficial interest in any property: S. 149 D (1) (m a )

## **7. ADVANTAGES AND DISADVANTAGES OF BANKRUPTCY**

### **7.1 ADVANTAGES OF BANKRUPTCY**

### **7.1.1 Stops Action by Unsecured Creditors**

For most debtors, the major advantage of bankruptcy is that it stops action against them by unsecured creditors in relation to most debts which are part of the bankruptcy (s. 58 (3)). As set out in the section above entitled 'Provable Debts', most debts which a person has at the date they become bankrupt are part of the bankruptcy – that is, they are provable debts (s. 82).

Because the Bankruptcy Act is a law of the Commonwealth, it prevails over any inconsistent state law. (Australian Constitution s. 109). Debtors can get protection from action against their person or property in regard to most provable debts firstly by lodging a Declaration of Intention to Present a Debtor's Petition (s. 54 A) which is described earlier in this paper. This gives them twenty-one days protection, in which time they can decide if they wish to become bankrupt. If they decide to petition in their bankruptcy, they get permanent protection from action against them for most provable debts. See the section entitled 'Provable Debts' earlier in this paper, and in particular the special status of child maintenance and child support debts. Bankruptcy does not protect a bankrupt from enforcement relating to a child support or maintenance debt (s. 58 (5A) ).

### **7.1.2 Effect of Bankruptcy on Secured Debts**

The general rule set out in subsection 58 (3) of the Bankruptcy Act is that when a person becomes bankrupt, no further action can be taken against them, or their property in regard to a provable debt. Subsection 58 (5) provides an important exception to this. It provides that the general rule does not affect the right of a secured creditor to seize and sell its security.

The effect of this is that a secured creditor which has a mortgage, lien or charge over property can seize and sell the property despite the fact that the borrower has become bankrupt. However, the secured creditor cannot go beyond this

action, and pursue the bankrupt for any shortfall. The creditor is limited to action against the secured property.

When the bankrupt is discharged at the end of the bankruptcy, the discharge releases the bankrupt from all debts provable in the bankruptcy, including secured debts (s. 153 (1) ), with the exceptions set out in the section entitled Exceptions to Discharge earlier in this paper (s. 153 (2) ).

### **7.1.3 Wide Range of Protected Property**

Another major advantage of bankruptcy is that a wide range of property is protected, in contrast with the narrower range of property protected by State judgment enforcement law. For a list of the types of property protected in bankruptcy, see the section entitled 'Protected Property' above. For the list of property protected by Western Australian judgment enforcement law, see Civil Judgments Enforcement Regulations 2005, regulation 35.

### **7.1.4 Even Distribution of Assets Amongst Creditors**

If a debtor becomes bankrupt, any unprotected property or income that may become available for distribution amongst creditors is divided amongst them in proportion to the amount of the debt (s.108). This may be important to a debtor who owes money to family members.

### **7.1.5 Interest Is Frozen**

Interest on a debt is frozen as at the date of the bankruptcy. This is important for a debtor who has been trying to pay off a large debt on which interest keeps accruing. Interest is frozen due to the operation of s. 82 (3B) of the Bankruptcy Act, which provides that interest accruing on a provable debt in respect of a

period of time commencing on or after the date of the bankruptcy is not a provable debt.

### **7.1.6 Discharge – Significance**

At the end of a bankruptcy, normally after three years, the bankrupt gets a discharge from most provable debts. This means the debts legally cease to exist (s. 153 (1)). For a list of those debts from which a bankrupt does not get a discharge, see the section entitled 'Exceptions to Discharge' above.

The significance of discharge for bankrupts is that they are freed from most of the debt which was a part of the bankruptcy. In contrast, a debtor who does not become bankrupt can be sued up to six years after the last part payment of a debt, or written acknowledgement of it, for most debts (Limitation Act 2005 WA s. 13 and ss. 47 - 51). In the case of a mortgage debt, the creditor has twelve years to sue, (Limitation Act s. 20). Once a creditor has sued and obtained a judgment, the creditor has twelve years from the date of the judgment to enforce it: (Civil Judgments Enforcement Act 2004 WA s. 12). From this it is clear that a debtor who tries to pay their way through a substantial burden of debt may spend many years before feeling safe from creditor's enforcement action: perhaps up to twenty-four years in the case of a mortgage debt. In contrast, a debtor who decides to become bankrupt can look forward to being debt-free and able to make a fresh start after three years.

## **7.2 DISADVANTAGES OF BANKRUPTCY**

### **7.2.1 Non-Protected Property Vests In Trustee**

Non-protected property of the bankrupt, that is everything owned by the bankrupt other than the protected property listed above – becomes the property of the trustee in bankruptcy. Non-protected property includes houses, land, business, caravan, boat, bank accounts and shares. Some business equipment is



protected if it is within the definition of tools of trade (property used by the bankrupt to earn income by personal exertion), and a boat may be protected if it is used by the bankrupt primarily as a means of transport. See the sections above entitled Dealing With Equity in a Property, Equity in Vehicles, and Time Limitation on Trustee for Realizing Property.

### **7.2.2 After-acquired Property Vests in Trustee**

In the Bankruptcy Act, the term 'after-acquired property' is used to refer to property which the bankrupt acquires or becomes entitled to during the time they are bankrupt. After acquired property vests in the trustee (s. 58 (1) (b) ), unless it is protected property (s. 116 (1) and (2) ). Debtors considering bankruptcy should take this into account in their planning. Lottery wins and inheritances are common examples of unexpected after-acquired property. A person becoming bankrupt would wisely avoid buying a lottery ticket for themselves, and if they have well-off relations, who may leave them an interest in a will, they can suggest to the relations that any gift be to a testamentary discretionary trust, of which the bankrupt may be one of the beneficiaries.

### **7.2.3 Contributions From Income**

Bankrupts who have income above a set income level are required to make contributions from income (s. 139 P). The level (inflation adjusted) is currently \$56,674.80. This is net income after deduction of any tax or child support payable. (s.139N). The protected income threshold is increased by the child support percentages (18, 27, 32, 34 and 36) for each dependant. A dependant is a person who:

- a) resides with the bankrupt: and

- b) is wholly or partially dependent on the bankrupt for economic support:  
and
- c) earns or is likely to earn less than \$3,610 per annum (inflation adjusted) during the contribution assessment period in question. (s. 139 K).

Excess income above that level is divided equally with the trustee during the period of the bankruptcy. This figure changes periodically and may be checked by looking at the AFSA website, which is [www.afsa.gov.au](http://www.afsa.gov.au). Go to Indexed Amounts.

If the bankrupt owes income contributions at the end of the bankruptcy, these are not discharged (s. 153 (2 (aa)). The bankrupt must pay them.

#### Income contributions and Hardship

If a bankrupt is required to pay contributions from income, but this causes hardship due to expenses of certain specified types, the bankrupt can apply in writing to the trustee for the expenses to be taken into account in assessing the level of contributions. The specified expenses are:

- \* medical expenses for the bankrupt or a dependant:
- \* child care costs necessary to enable the bankrupt to work:
- \* private rental costs:
- \* substantial expenses travelling to work by public transport or otherwise;
- \* a member of the bankrupt's household who ordinarily contributes to the expense of the bankrupt's household is unable to contribute due to unemployment, illness or injury (s. 139 T)

#### 7.2.4 Limitation On Overseas Travel

All bankrupts are required to seek the permission of the trustee before going overseas. The trustee may impose written conditions on the consent. If the bankrupt is liable to make contributions from income the conditions may relate to payment of the contributions (s. 272 (2) ). An application by a bankrupt for permission to travel overseas must be accompanied by a \$150.00 fee.

Leaving Australia without the trustee's written permission is an offence punishable by up to five years imprisonment (s. 272 (1) ). This prohibition extends to leaving Australia with intent to defeat or delay creditors within six months **before** the presentation of a petition due to which a person becomes bankrupt, and to doing acts preparatory to leaving Australia with intent to defeat or delay creditors in that time interval. Debtors who are insolvent, and are thinking of leaving Australia, should consider these provisions carefully.

#### 7.2.5 Management of a Company

A bankrupt cannot be a director of a company, or take part directly or indirectly in the management of one (Corporations Act 2001 s. 206 B (3) Commonwealth).

A person who entered a personal insolvency agreement under Part X of the Bankruptcy Act is also disqualified from managing corporations until the terms of the personal insolvency agreement have been fully complied with: (Corporations Act 2001 s. 206 B (4) ). This section does not prevent a person in part 1X debt agreement managing a corporation.

The definition of **managing corporations** is very wide. It includes:

- \* making, or participating in making, decisions that affect the whole or a substantial part of the business of the corporation;

- \* exercising the capacity to affect the corporation's financial standing;
- \* communicating instructions or wishes to the directors of the corporation, knowing or intending that the directors will act in accordance with their wishes. There is an exception in regard to advice given by the disqualified person in the proper performance of their professional capacity, or business relationship. An example of the exception is that a disqualified person who was an accountant or solicitor could give accounting or legal advice to the directors: Corporations Act 206A.

The disqualification does not extend to a person who is a debtor in a debt agreement: Corporations Act s. 206 B (3)and (4).

A person who becomes bankrupt, or enters a Part X personal insolvency agreement, automatically ceases to be a director, alternate director or secretary of a company if they become disqualified from managing corporations under these provisions (and they have not specifically been given permission to manage a corporation under other provisions of the Act. (Corporations Act 2001 206A (2) ). A person who automatically ceases to be a director etc. under these provisions should notify ASIC.

### **7.2.6 Adverse Effect on Employment**

A number of categories of employment are adversely affected by bankruptcy. In general, employment requiring registration with a particular body, such as the legal profession, real estate agents, security personnel, painters and builders, and employment imposing moral or ethical standards such as police, armed services, chartered accountants, public service and membership of parliament will be ended or adversely affected by bankruptcy.

Division 10A of the Aged Care Act 1997 (Commonwealth) provides that an insolvent under administration cannot be one of the key personnel of an aged care establishment. Key personnel (s. 8 – 3A) means a person responsible for management, nursing or day-to-day operations of the service or organization. Insolvent under administration means a person who is bankrupt; or has given an authority under section 188 or is the subject of a court order under section 50 of the Bankruptcy Act; or is in a Part X personal insolvency agreement. These terms are defined to include foreign equivalents. It does **not** include a person in a debt agreement.

All debtors contemplating bankruptcy should inquire whether bankruptcy will affect their employment. A person who goes on to follow a career path involving responsible jobs is very likely to be adversely affected at some point in their career by the fact that they were bankrupt in the past, even if it is many years before. See the section entitled 'Adverse Effect on Financial Reputation' which follows this section.

### **7.2.7 Adverse Effect On Financial Reputation**

Bankruptcy has a permanent adverse effect on the way a person is viewed by a prospective lender, and is disadvantageous to any person whose financial history may be examined closely.

Each bankruptcy, debt agreement, and personal insolvency agreement is entered on the National Personal Insolvency Index (Bankruptcy Regulation 13.03). This is a permanent record which is accessible to the public (Regulation 13.06).

Bankruptcy is also recorded on a person's credit report, where it is retained for:

- \* five years from the date the person becomes bankrupt, or
- \* two years from the date the bankruptcy ends; whichever is the later

Each person considering bankruptcy should make a realistic long-term appraisal of the likely effect of bankruptcy on their plans for a career, or to buy a house or other major purchase. All prospective creditors are entitled to ask a prospective borrower whether they have ever been bankrupt, or in any insolvency arrangement.

### **7.2.8 Limit On Credit**

During the time persons are bankrupt, they are required to disclose their bankruptcy to anyone from whom they are seeking credit for more than \$5,726 (s.269 (1)). This figure is adjusted quarterly with inflation. The same disclosure requirement applies to writing cheques, entering leasing and hiring arrangements, and contracts relating to obtaining goods and services on credit above that figure. This disclosure requirement extends to people who are debtors in a debt agreement: ( s.269 (1)).

### **7.2.9 Limit On Use of Business Name**

Bankrupts carrying on business under an assumed name, in the name of another person, or under a business name must disclose to everyone with whom they deal their true names, and the fact they are undischarged bankrupts. (s. 269 (1) (b) ). This disclosure requirement also extends to people who are debtors in a debt agreement: (s. 269)).

### **7.2.10 Effect On Guarantors**

The protection given by subsection 58 (3) of the Bankruptcy Act to bankrupts does not extend to guarantors of the bankrupts debt. Discharge of the bankrupt

does not discharge the liability of a guarantor (s. 153 (4) (b) ). The effect of these provisions is that the bankrupt obtains freedom from the debt, but the guarantor is left with it. A bankrupt who is freed of other debts may be able to assist the guarantor to pay the guaranteed debt.

#### **7.2.11 Not All Debts Are Provable**

As set out above in the section headed Non-Provable Debts, not all debts are part of a bankruptcy.

#### **7.2.12 Not All Debts Are Discharged**

As set out above in the section headed Exceptions to Discharge, a bankrupt does not get a discharge from all debts at the end of a bankruptcy.

#### **7.2.13 Secured Creditors Can Deal With Secured Property**

As set out above in the section headed Effect of Bankruptcy on Secured Debts, a secured creditor can seize and sell secured property if a bankrupt is in default under the contract. The bankrupt is protected against a shortfall.

#### **7.2.14 Effect On Tax Refunds**

As set out in the section headed Tax Refunds in Effects of Bankruptcy, a tax refund received by a bankrupt which relates to income earned before the person became bankrupt goes to the trustee in bankruptcy as after acquired property. A tax refund which relates to income earned when a person is bankrupt is added to the bankrupt's income, to see if the bankrupt is liable to make a contribution from income (s. 139 N (1) (b) ).

### **7.2.15 Bringing Offences to Light**

There are a number of actions or omissions which, on their own, are not offences, but which become offences if the person becomes bankrupt within a particular time after the conduct in question. That is, becoming bankrupt completes the offence.

Ian Macdonald  
Solicitor  
FCAWA

August 2018



## **CASE STUDY – NO. 1**

### **BANKRUPTCY 2018**

Norton and Alma have come to see you about their financial difficulties. They bring in a large shopping bag of papers, and Norton says they are in such a mess, he doesn't know where to start. A book sticking out of the bag has 'Shop Accounts' written on it, and you ask about that.

Norton explains that for the last six years, he and Alma ran a general store in Flinders Valley, a small town halfway between Perth and Kalgoorlie. They built up the business in the first five years, and were making a good profit, so their landlord, Mr. Wizen, put up the rent. They signed a lease for another five years, with an option of a further five years. Things went well until six months ago, when a major national chain opened a supermarket a block away from them. The supermarket's opening specials offered goods cheaper than Norton and Alma could buy them from wholesalers. The only way they could make anything from the business was by opening late at night, and on Sundays. This was wearing them down, and they were going backwards. They asked Mr. Wizen to reduce the rent, but he refused. Last month they could not pay the rent, and when they arrived at the shop last Monday, Mr. Wizen had changed the locks. A travelling representative of a wholesaler warned them of this possibility some time ago, when they confided in him, so they had not left any cash or personal possessions in the shop. However, Norton is rather worried about the stock still in the shop. Mr. Wizen said he is just going to help himself, and eat his way through the stock until they pay him the rent. Norton says that under his agreement with the wholesalers he and Alma have given a floating charge over the stock, and they are responsible for it. They owe \$50,000 to the wholesalers. Mr. Wizen said he will go on charging them rent until the five years is up, and sue them for the lot. The rent is \$2,500 per month, plus outgoings, and by the time five years is up the bill will total about \$150,000.

Alma says that things would not be so bad if all their customers had paid their bills. A number of their customers had run accounts, and there is \$12,500 owing to Norton and Alma. Alma is worried that Mr. Wizen will try to collect the money.

Another folder sticking out of the bag says 'Home Mortgage'. You ask about that.

Alma explains that they bought a house in Flinders Valley a few years ago, when prices were higher than they are now. At the time there were rumours that a major mining company was going to reopen an old gold mine in the town. However, talk of this fizzled out, and prices have gone back to their pre-rumour level. The house is worth \$150,000 now, and they owe \$200,000 on it. The repayments are \$1,125 per month, which they can manage. It is less than they would pay for rent for a similar house in Flinders Valley. They want to keep the house. You ask how they can manage the mortgage payments.

Norton explains that as soon as they were locked out of the shop, Alma went back to her old job at the Flinders Valley Aged Care Facility. He got a job as casual barman and thrower-out at the Flinders Valley Arms. They are managing a lot better now than when they were in the shop.

A file marked 'Car Finance' is the next in the pile. You ask about that.

Norton explains that relates to a four wheel drive wagon registered in his name. They use it to transport the family around: they have two children and two large dogs. They owe \$16,000 on it. It is registered in Norton's name. He thinks it is worth \$8,000, or perhaps a bit less because he uses it for prospecting trips around Flinders Valley. Alma also has a car, registered in her name. She has checked it on Red Book and it is worth about \$5,000. She does not owe anything on her car.

The last file is titled 'Overdue Reminders'. Alma says she does not want to look at it. It includes a bill from the wholesalers for the \$50,000 owing on the stock, and a statement showing \$12,500 overdraft on the shop account. Alma says they pay their wages into the same bank, and are worried the bank may take money from their savings account to pay the overdraft. You ask about the value of the stock in the shop. Alma estimates the stock is worth \$100,000, but it is declining as various items reach their use-by dates, and Mr. Wizen continues to eat the stock.

Alma says she has done a bit of research on the internet, and bankruptcy sounds interesting. She wants to know a few things about how it would affect them. She asks, if they become bankrupt:

1. What will happen to the stock in the shop?
2. What will happen about the \$50,000 they owe on the stock?
3. What will happen about the rent they owe Mr. Wizen now?
4. What will happen about the rent which will fall due during the rest of the five year term?
5. What will happen about the \$12,500 which their customers owe them?  
Can Mr. Wizen collect it?
6. What will happen to their house?
7. What will happen to Norton's four wheel drive wagon?
8. What will happen to Alma's car?
9. Will bankruptcy affect Norton's work?
10. Will bankruptcy affect Alma's work?
11. Can the bank take money from their savings account to off set against the overdraft? Can you suggest any moves they could make relating to this?

Ian Macdonald

August 2018

## CASE STUDY - NO. 2

### BANKRUPTCY 2018

Oliver Slip is due to see you this afternoon. His file shows that he saw you six months ago, and at that time he was in financial difficulty. Your file notes indicate that Oliver had been conducting a business he called Oliver's Pie Cart from a van in a remote mining town. The mine closed, Oliver's customers flew out, and did not fly back. Oliver took the van on the road, but had difficulty making ends meet. He was moved on by council inspectors in towns he travelled through, and was fined for breaches of town rules. He used credit cards to buy fuel for the van, and food for his business, and himself. His fines totalled \$5,000, and his credit card debt \$55,000. His assets were his van which was on a commercial lease, from First Settler Finance, a caravan he owns worth \$75,000, and his cooking equipment worth \$3,000.

Your file shows that Oliver had sought advice about bankruptcy, and that you informed him that if he became bankrupt:

- \* his van would be substantially unaffected by bankruptcy. If he wanted to keep it, he would have to keep paying for it. If he stopped paying, the finance company could take it back, and sell it, but any shortfall would be a debt in the bankruptcy;
- \* he would lose his caravan. You advised him that a caravan is not protected in bankruptcy, and as he owns it outright the trustee would take it, sell it, and put the money into the bankrupt estate;
- \* his cooking utensils would be protected as tools of trade;
- \* his fines would be unaffected by bankruptcy;

- \* a trustee might examine how and when he ran up \$55,000 on his credit cards, and ask if he had got credit without having any reasonable expectation of being able to pay it.

Your summary to him was that you suggested he go away and think about it, and not rush into bankruptcy because it might cause him problems.

In the light of this, you wondered what he might say when he arrives this afternoon. As you turn the file's pages, you see there is an e mail from him that arrived recently. In his e mail to you, Oliver says:

- \* He has had a bit of luck in the six months since he saw you.
- \* His Uncle Denis was discharged from the Army with a good payout. He has joined Oliver in the Pie Cart, and they are operating it in partnership in a nice seaside town where trade is good.
- \* He told Uncle Denis what you said, and Uncle Denis has acted on your advice. He is keen to meet you.
- \* He and Uncle Denis contacted First Settler Finance about the van, and have transferred the lease into Uncle Denis' name.
- \* Uncle Denis has bought the caravan from him for \$5,000, which he has used to pay all of his fines.
- \* All he now has is the cooking utensils, which you said are protected in bankruptcy, and the credit card debt of \$55,000. He thinks he has let enough time pass there, as he has not used the cards since he spoke to you. He would like you to help him fill out the forms to make him bankrupt when he calls in this afternoon.

Oliver comes into your office at the appointed time, and introduces his Uncle Denis. Uncle Denis says he is most appreciative of the good advice you have given young Oliver, and looks forward to more good advice from you.

1. Do you plan to give Oliver and Uncle Denis advice?
2. Your file note shows you told Oliver the van would be substantially unaffected by bankruptcy, but Oliver has transferred the lease to Uncle Denis. Would this transfer cause any problems if Oliver became bankrupt?
3. Oliver told you his caravan was worth \$75,000, but he sold it to Uncle Denis for \$5,000 to get money to pay his fines. Would this create a problem if he became bankrupt?
4. Oliver's fines totalling \$5,000 were paid by Uncle Denis recently. Would this create any problem if Denis became bankrupt?
5. It is about six months since Oliver used any of his credit cards. The debt was \$55,000. Oliver has not received any statements from his creditors recently, so it would be more now, with interest added. Is this likely to create a problem if Oliver becomes bankrupt now?
6. Oliver is now operating the pie cart business in partnership with Uncle Denis. What would happen to the partnership if Oliver became bankrupt now?
7. What would happen to the pie cart business if Oliver became bankrupt now?

8. Oliver is very fond of the name Oliver's Pie Cart. It has a long tradition behind it. What would happen to the name if Oliver became bankrupt?
9. How do you see the balance of advantage and disadvantage to Oliver of becoming bankrupt now?
10. Do you see any alternatives to bankruptcy about which you could give information to Oliver?

Ian Macdonald

August 2018

## **CASE STUDY – NO. 3**

### **BANKRUPTCY 2018**

Terry and Stephanie have asked for your assistance relating to a car accident which Terry was involved in late last year. They have both been contacted about it.

Terry explains that his car was overheating, so he borrowed Stephanie's car to go to football training. Stephanie asked him to pick up some milk on the way back. However, he had a few drinks after training, and forgot the milk. On his way home he was distracted by all the different coloured lights on the dashboard, and crashed into the back of an Aston Martin. The insurers of that car claimed it sustained \$100,000 damage. Stephanie's car was written off. Fortunately, the airbag deployed, and Terry was not injured. Police attended the accident. Terry was charged, and has been convicted of a drink-driving offence and careless driving. Stephanie made a claim on her car's insurance, but her claim was rejected due to Terry's conviction stemming from the accident.

Stephanie is very cross about the whole thing. Her car was worth \$15,000 before the accident, but it now is scrap value only, at \$500. She and Terry still owe \$18,000 on a loan contract secured on the car. They are jointly and severally liable on the contract.

Stephanie asks:

1. Can she sell the wreck for \$500 and use the money to get Terry's car repaired?
2. If Terry becomes bankrupt, will she still have to pay on the loan secured on her car:



- \* half of the amount owing
- \* all of the amount owing
- \* none of the amount owing

Stephanie has received a letter addressed to her from the insurers of the other car involved in the accident demanding \$100,000 because she is the owner of the vehicle involved, and at the time of the accident it was being driven by Terry as her servant or agent.

3. Is Stephanie liable?

4. Is it wise for Stephanie to do anything at this stage?

Terry feels quite annoyed that the insurers of the other car involved in the accident are asking him pay \$100,000. He says that if people want to drive around in expensive cars they should stay out of his way. He has not got \$100,000, but if he did he would not give it to them anyway. He thinks he would like to go bankrupt right now and get them all off his back: the insurance company, the finance contract on Stephanie's car, and his drink-driving fine. If Terry becomes bankrupt now, will he get rid of:

5. The claim by the insurers of the other car involved in the accident:

6. His liability under the finance contract on Stephanie's car;

7. His drink-driving fine?

Stephanie is not too concerned about the idea of Terry becoming bankrupt. She is not too happy about paying \$18,000 on a car now worth \$500, and may consider bankruptcy herself if people start pushing her. If she and Terry both became bankrupt, what would happen to:

8. The computers and books that each of their children have for their school work?
9. The sporting equipment each of their children has?
10. Terry's car. With its mechanical problems it is worth \$8,000, but if it were repaired it would be worth \$10,000. It is fully paid for, from their joint earnings.

Terry is the trustee of an educational trust set up by Terry's father. The beneficiaries are the children of Terry and his brothers and sisters.

11. If Terry becomes bankrupt, will the assets of the trust vest in Terry's bankruptcy trustee?

Terry works in two jobs, as a gym instructor and a sports scientist.

12. If Terry becomes bankrupt, will his work in these occupations be affected?

Due to working in two jobs Terry's income is fairly complicated. He has not done a tax return yet for the last tax year. He usually gets a refund. If Terry becomes bankrupt:

13. What would happen to a refund from the last tax year?
14. What would happen to a refund relating to the current tax year?

Terry has been paying child support, on and off, for a period of several years. He has a child support debt of \$7,000, and owes \$5,000 in late payment penalties. If he becomes bankrupt:

15. What would happen to his \$7,000 child support debt?

16. What would happen to the \$5,000 late payment penalties?

Stephanie feel uncomfortable about the claim the insurers of the other car involved in the accident. She feels she was not responsible, but the idea still bothers her. She also does not know how much the finance company which has the secured loan on her car will ask her to pay. Every time she gets a letter from them, the amount they ask for goes up. She has stopped paying them. If Stephanie becomes bankrupt:

17. Would the insurers of the other car involved in the accident still be able to persist with their claim against her?

18. Would the finance company still be able to pursue her for money owing under the contract?

19. Would Stephanie's employment be affected? She is in charge of nursing care at an aged care facility.

20. Are there any suggestions or strategies you can suggest to Terry and Stephanie relating to their situation?

Ian Macdonald

August 2018