

1.0 INTRODUCTION

Bankruptcy is a legal process designed to deal with an inability by an individual to pay their debts. In bankruptcy, the estate of a debtor is administered by a Trustee in Bankruptcy who is either the Official Trustee (a public servant) or a private Trustee. A trustee is required to manage the affairs of the bankrupt, realise their assets for distribution amongst creditors, and investigate the circumstances surrounding the appointment. Speaking generally, bankruptcy is designed to be a rehabilitative process, rather than punitive. It is worth noting that partnerships and deceased estates may also be bankrupt, and that similar provisions are in place to deal with these variations.

The relevant legislation is the *Bankruptcy Act 1966* ("**the Act**"), the *Bankruptcy Regulations 1996* ("**the Regulations**") and the *Bankruptcy (Estate Charges) Act 1997*.

2.0 BECOMING A BANKRUPT

There are two (2) ways a debtor can become bankrupt, namely:

- (i) Debtors' Petition (section 55 of the Act) – Where a debtor presents his or her own petition to the Official Receiver; or
- (ii) Creditors' Petition (section 43) – Where a creditor presents a petition to the Court and a sequestration order is made against the estate of a debtor.

A petition presented by a debtor must be accompanied by a Statement of Affairs which sets out the particulars of the debtor's assets, liabilities and financial circumstances. For a petition to be presented by a creditor, the debtor will need to have committed an act of bankruptcy. The numerous acts of bankruptcy are set out in section 40, the most

common being non-compliance with a Bankruptcy Notice which is a statutory notice requiring the debtor within 21 days of service to either pay the debt claimed or enter into an arrangement to settle the debt (section 41). In addition, the debtor must be indebted to the petitioning creditor(s) for an amount of at least \$5,000 (section 44).

3.0 DUTIES OF A TRUSTEE

In presenting a petition, a debtor or a creditor can nominate a Trustee to act and if no such nomination is made, then the Official Trustee is appointed. The duties of a trustee are set out in section 19 of the Act and include:

- (i) investigating the financial affairs of the bankrupt;
- (ii) realising all available property of the bankrupt including transactions that may be voidable;
- (iii) investigating whether any offences have been



committed by the bankrupt and if so, reporting those offences accordingly; and

- (iv) distributing to creditors realised funds in accordance with the Act.

4.0 DUTIES OF A BANKRUPT

Where a sequestration order is made, a bankrupt is required pursuant to section 54 of the Act to make out and file with the Official Receiver a Statement of Affairs which requires primarily particulars of assets and liabilities.

The general duties of a bankrupt are set out in section 77 and include:

- (i) providing books and records to the Trustee together with his or her passport;
- (ii) providing such information about the bankrupt's conduct and examinable affairs that the Trustee reasonably requires;
- (iii) attending upon the Trustee as he or she reasonably requires; and
- (iv) disclosing to the Trustee divisible property that is acquired by or devolves upon the bankrupt prior to discharge.

In addition, a bankrupt has obligations pursuant to the income contribution regime set out in the Act and in particular the obligation to:

- a. provide information in relation to income, derived and to be derived (section 139U);
- b. pay assessed income contribution amounts to the Trustee (section 139P).

Further comment in relation to income contributions is made in section 6 hereof.

5.0 PROPERTY OF THE BANKRUPT

5.1 Vesting of Property

Where a debtor becomes bankrupt, his or her property vests forthwith in the trustee (subsection 58(1) of the Act). Property is defined in section 5 of the Act to include "real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or

contingent, arising out of or incident to any such real or personal property".

Property acquired after bankruptcy and before discharge also vests in the Trustee as soon as it is acquired by, or devolves on the bankrupt (subsection 58(2)). A good example of after-acquired property is the receipt of an inheritance.

5.2 Property Divisible to Creditors

All property of a bankrupt that belonged to, or was vested, in a bankrupt at the commencement of a bankruptcy, and all after-acquired property of the bankrupt is property divisible amongst the creditors of the bankrupt (subsection 116(1)(a) of the Act). However there are limitations on what constitutes divisible property.

5.3 Property not Divisible Amongst Creditors

In accordance with subsection 116(2) of the Act, certain property of a bankrupt is not divisible amongst creditors. This property includes the following:

- (i) Property held in trust for another person (subsection 116(2)(a));
- (ii) Necessary clothing and household property and such other household property that creditors may resolve (subsection 116(2)(b));
- (iii) Items of sentimental value, including awards of sporting, cultural, military or academic nature, as creditors may resolve (subsection 116(2)(c));
- (iv) Property that is used by the bankrupt in earning income by personal exertion whose aggregate value does not exceed an indexed value (currently \$3,700) and such other equipment as the creditors may resolve or the Court may order (subsection 116(2)(d));
- (v) Property used primarily as a method of transport up to an indexed value (currently \$7,600) (subsection 116(2)(ca));
- (vi) Subject to certain conditions, life assurance and endowment assurance policies and proceeds from the policies in respect of the bankrupt and the bankrupt's spouse and the bankrupt's interest in superannuation policies



- and proceeds thereof (subsection 116(2)(d));
- (vii) Any right of the bankrupt to recover compensation, damages and right of action for the death, personal injury or wrongs to oneself, their spouse or any family member (subsection (116(2)(g));
- (viii) Property subject to orders under the Family Law Act 1975 (subsections 116(2) (q) and (r)).

6.0 INCOME CONTRIBUTIONS

As noted earlier herein, If a debtor receives or is deemed to have received income above indexed amounts, then the debtor is liable to make contributions to his or her bankrupt estate. The definition of income is very broad and includes income from personal exertion, loans from associated entities, and taxable fringe benefits (section 139L of the Act).

The amount of the amount of the contribution required to be paid by a bankrupt is 50% of the after tax income which exceeds the “actual income threshold amount” (section 139S).

The actual income threshold amount is the amount of income a bankrupt may earn upon which no contribution is payable. In accordance with section 139K, the threshold amount is determined by reference to the number of dependants for whom the bankrupt is responsible. The current amounts, which are updated twice yearly, are set out in the table below.

Number of Dependants	Threshold Amount
0	\$53,653.60
1	\$63,311.25
2	\$68,140.07
3	\$70,822.75
4	\$71,895.82
Over 4	\$72,968.90

For further information in relation to income contributions, please refer to our newsletter Income Contributions & Accumulated Savings.

7.0 CONSEQUENCES OF BANKRUPTCY

The main consequences of becoming a bankrupt include the following;

- (i) Particulars of the bankruptcy will be recorded on the National Personal Insolvency Index for life.
- (ii) A bankrupt’s credit rating will be affected for 7 years unless annulled prior to discharge.
- (iii) A bankrupt can become liable to make contributions from his or her income (section 139P of the Act).
- (iv) Property acquired after bankruptcy can vest in the Trustee (subsection 58(2).
- (v) A bankrupt cannot, without disclosing that he or she is an undischarged bankrupt, obtain credit (including the leasing or hiring of goods) or obtain goods or services from a person for an amount greater than an indexed amount (currently \$5,447) (subsections 269(1)(a) to (ad)).
- (vi) A bankrupt cannot carry on business alone or in partnership, under a name other than their own unless he or she discloses their real name and the fact that he or she is an undischarged bankrupt (subsection 269(b)).
- (vii) A bankrupt is allowed to travel overseas but only with the written consent of the Trustee who may impose conditions upon giving consent (subsection 272(2)).
- (viii) A bankrupt is disqualified from acting as director and managing a corporation (subsection 206B(3) of the Corporations Act 2001).
- (ix) Creditors are unable to enforce any remedy against the bankrupt or his or her property in respect of a provable debt nor are creditors able, except with leave of the Court, to commence any legal proceedings in respect of a provable debt or take any fresh step in such a proceeding (subsection 58(3)).



8.0 VOID TRANSACTIONS

Realisations from transactions that are void against a Trustee are divisible property of a bankrupt. The transactions that are potentially voidable are listed below:

8.1 Undervalued Transactions

Section 120 of the Act applies to transfers of property for nil consideration or consideration that was less than market value that took place 5 years before the date of bankruptcy. However, the transfer is not void in the case of a transfer to a related party, if the transfer took place more than 4 years before the commencement of bankruptcy and the transferee proves that at the time of the transfer, the transferor was solvent. In any other case, the time period is 2 years.

8.2 Transfers to Defeat Creditors

Section 121 of the Act applies to transfers of property where the transferor's main purpose was to either prevent the transferred property from becoming divisible property of the bankrupt or, to hinder or delay the process of making property available for division amongst the bankrupt's creditors. There is no time limit to attack these transfers.

8.3 Preference Payments

Section 122 of the Act applies to transfers of property which had the effect of giving the creditor a preference, priority or advantage over other creditors. In the case of a creditor's petition, the transfer must have been made in the period beginning 6 months before the presentation of the petition and ending immediately before the date of bankruptcy. The same applies to a debtor's petition where there is no creditor's petition pending. If there is a creditor's petition pending, then the transfer must have been made in the period beginning on the commencement of the debtor's bankruptcy and ending immediately before the date of bankruptcy.

8.4 Protection of Certain Transfers

Subsection 123(1) of the Act, certain transfers and transactions are not void against the Trustee if:

- (i) the transaction took place before the day on which the debtor became a bankrupt;
- (ii) the person, other than the debtor, with whom it took place, did not, at the time of the transaction, have notice of the presentation of the petition against the debtor; and
- (iii) the transaction was in good faith and in the ordinary course of business.

9.0 OFFENCES

Offences committed under the Act have been categorized by the Australian Financial Security Authority as either compliance offences or complex offences.

9.1 Compliance Offences

Compliance offences are administrative-type offences where an individual, whether bankrupt or not, has failed to comply with a legislated requirement under the Act or the Regulations. Typical examples of these types of offences are:

- (i) failure to submit a Statement of Affairs (subsections 54(1) & (2));
- (ii) failure to provide evidence of income (subsection 139U(1));
- (iii) failure to disclose property and information (section 265(1))

The penalty for certain compliance offences can be 12 months imprisonment.

9.2 Complex Offences

Complex offences are those offences which do not fall within the definition of compliance offences. Examples of these types of offences are;

- (i) Concealment of property with intent to defraud (section 263(1));
- (ii) Obtaining credit without disclosing bankruptcy (section 269(1));
- (iii) Gambling or hazardous speculations (section 271);



- (iv) Leaving Australia with intent to defeat creditors (section 272)

The penalty for certain complex offences can be imprisonment for up to 5 years.

10.0 THE PERIOD OF BANKRUPTCY

10.1 Statutory Period

Pursuant to section 149 of the Act, a bankrupt is automatically discharged three (3) years from the date he or she files with the Official Receiver a Statement of Affairs. However, if the conduct of the bankrupt is unsatisfactory, the Trustee can file an objection to extend the period of bankruptcy.

10.2 Objection to Discharge

Pursuant to section 149B of the Act, at any time before discharge, a Trustee may file with the Official Receiver a written notice of objection to the automatic discharge of a bankrupt. The numerous grounds upon which an objection can be made are set out in sub-section 149D(1) of the Act and include;

- (i) any transfer of property that is void pursuant to sections 120, 121 or 122 of the Act (subsections 149D(1)(aa) and (ab));
- (ii) failure to provide particulars of income or expected income (subsection 149D(1)(e));
- (iii) failure to pay assessed income contributions (subsection 149D(1)(f));
- (iv) failure to disclose, whether intentionally or not, the bankrupt's beneficial interest in any property (subsection 149D(1)(n)).

If an objection has taken effect, then subject to the ground(s) upon which the objection was made, the period of the bankruptcy will be extended by up to five (5) years.

10.3 Early Discharge

At any time before discharge, a debtor can seek an annulment:

- (i) pursuant to subsection 73(1) of the Act by submitting a written proposal to the Trustee who must convene a meeting of creditors. The trustee may decline to convene the meeting if

sufficient funds are not advanced to meet the costs of arranging and holding the meeting (subsection 73(5)). For the proposal to be accepted, creditors will need to pass a special resolution (subsection 74(5)), which requires a majority in number and at least 75% in value of creditors present to vote for the motion;

- (ii) pursuant to section 153A by advancing to the Trustee sufficient funds to pay out creditors in full (including interest on interest-bearing debts) plus the costs of the bankruptcy;
- (iii) pursuant to section 153B by making an application to the Court. If the Court is satisfied that a sequestration order should not have been made or in the case of a debtor's petition, that petition should not have been presented or accepted, the Court may make an order annulling the bankruptcy.

11.0 EFFECT OF DISCHARGE

On discharge from bankruptcy, a debtor is released from all debts (including secured debts), whether or not in the case of a secured debt, the secured creditor has surrendered his or her security for the benefit of creditors generally (subsection 153(1) of the Act). However and in relation to secured creditors, the discharge of a bankrupt does not affect the right of a secured creditor to realise or otherwise deal with his or her security (subsection 153(3) of the Act).

There are a number of debts in respect of which release is not obtained, the most notable being fines imposed by a Court, financial supplement debts (HELP) (subsection 82(3A)) and debts incurred by fraud (subsections 82(3) and 153(2)).

It should be noted that individuals who may be facing bankruptcy should seek immediate professional advice in relation to their specific circumstances.

Should you have any enquiries in relation to bankruptcy, annulment procedures or any associated issue, then please feel free to contact us at O'Brien Palmer for an obligation free assessment of your options.

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- Cash-Flow Management
- Turnaround Management

Without obligation or cost, we are available for an initial consultation. Please contact:

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