



Bankruptcy in Australia

**An information guide to
the consequences and
process of bankruptcy in
Australia**

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1. Overview

Thank you for ordering this e-book from Masons Lawyers. Masons Lawyers is a vibrant South East Queensland based law firm which specialises in a variety of areas of law including personal insolvency and bankruptcy. If you are reading this guide you are either looking at applying to bankrupt a person, have become bankrupt recently yourself or are interested in the bankruptcy process.

The process of bankruptcy is one that is intended to take account of the commercial interest of creditors and assist in the financial rehabilitation of debtors. It is a process that has been developed to ensure that assets owned by a person can be seized and sold to meet the demands of creditors whilst ensuring that the bankrupt is left with items essential to continue living and help that person re-establish themselves to become a productive member of society.

Whilst the process may seem unfair in some situations the process is an important one to allow for remedies for both the persons who cannot pay their debts and creditors. The process ensures that all steps are taken to rehabilitate a bankrupt to become productive and contributing members of society.

The purpose of this e-book is to give you a broad overview of the bankruptcy process and the consequences of bankruptcy. We will also look at some specific areas that effect people in their day to day lives including the consequences on their family home and in the building industry.

This e-book is made up of 7 Chapters (including this one) and is set out as follows:

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If you have any question please contact one of the Masons Lawyers' Insolvency Law team in either our Brisbane office on 3117 3780, our Caboolture office on 5428 1111 or on our Hotline 1300 000 LAW. Alternatively please visit our website at <http://masonslawyers.com.au/MasonsLawyers2163/Page/23411/InsolvencyLaw.aspx> for more information or contact us in relation to advice that you may need.

Yours Sincerely,

Masons Lawyers

Per: Jeremy Streten,
Legal Practice Director

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2. What is bankruptcy and its general consequences

2.1 What is bankruptcy?

A person is bankrupt or insolvent where they are unable to pay their debts, when they are due and payable. Bankruptcy is the process whereby a trustee is appointed to administer a person's estate to realise their assets for the benefit of creditors. The bankruptcy process is a legitimate and just way for a person to solve their debt problems and is one of the ways in which a creditor can take action against a debtor for unpaid debts.

There are two ways for a person to have a trustee appointed over their estate, these are:

- (a) Creditors petition – this is the process whereby a creditor applies to the Federal Court (or the Federal Magistrates Court) for a Sequestration Order (an order to deem a person bankrupt). This application is ordinarily made after a creditor has served a bankruptcy notice on the debtor and the debtor has failed to comply with the bankruptcy notice (Important note: the debt including costs and interest must be more than \$5,000.00).
- (b) Debtors petition – this is a process in which a person files a petition together with their statement of affairs with the Official Receiver (the Insolvency and Trustee Service Australia or ITSA). Once the petition is filed and allocated an estate number the person is bankrupt.

A statement of affairs is a document that must be completed by all bankrupts and sets out all of assets that they own and all of the debts that the person owes. This is an important document as the date that it is lodged ordinarily determines the date upon which the person is discharged from bankruptcy.

2.2 What are the effects of bankruptcy on the bankrupt?

Whilst a person is an undischarged bankrupt they have a number of obligations placed on them. These include:

- (a) They must make all of their books and records and financial statements available to their trustee;
- (b) They must surrender their passport and will have limitations on overseas travel;
- (c) Must make all of their divisible assets available to the trustee to be sold;



- (d) They cannot act as a director or secretary of a company;
- (e) They cannot trade under a registered business name without advising third parties that they are an undischarged bankrupt; and
- (f) They cannot incur credit over an indexed amount without advising the lender that they are an undischarged bankrupt.

2.3 **Can a bankrupt earn an income whilst they are bankrupt and what contribution will they have to pay to the trustee?**

Whilst a person is bankrupt they are permitted to earn an income and be employed. This is so that firstly the bankrupt can be rehabilitated to contribute to society financially and secondly where the bankrupt earns over certain prescribed amounts they are obliged to pay a percentage of that income to their trustee.

Not all money that is earned by a bankrupt is deemed to be income which can be used to contribute to the trustee in bankruptcy. Some of these include (for a complete list see *section 139L* of the *Bankruptcy Act*):

- (a) an amount paid to the bankrupt:
 - (i) from the Child Support Account established under the *Child Support (Registration and Collection) Act 1988* ; or
 - (ii) from another source for the maintenance of children of whom the bankrupt has custody; or
- (b) a payment to the bankrupt under:
 - (i) a legal aid scheme or service established under a law of the Commonwealth or of a State or Territory of the Commonwealth; or
 - (ii) a legal aid scheme or service approved by the Attorney-General for the purposes of *paragraph 2(4)(a)* of the *Federal Court of Australia Regulations*; or
 - (iii) any other legal aid scheme or service established to provide assistance to people on low incomes;
- (c) a payment or amount that the regulations provide is not income of the bankrupt.



The information detailing what a bankrupt earns is obtained either from the bankrupt themselves, the employer of the bankrupt or the Australian Tax Office.

2.4 Getting out of bankruptcy

Generally a person will be discharged from bankruptcy 3 years after they have lodged their completed statement of affairs with their trustee. It is important that this is completed promptly and completely to ensure that the period of bankruptcy is only 3 years.

There are certain circumstances in which this period can be extended. These have been included to encourage bankrupts to comply with the trustee to ensure the timely and just distribution of a bankrupt's estate. These include:

- (a) If the bankrupt has been found to have not disclosed all of their assets or income sources to their trustee in the statement of affairs;
- (b) There was a void transfer of property to a third party; and
- (c) After the date of the bankruptcy the bankrupt intentionally provided false or misleading information to the trustee.

Generally an extension will be either 2 years or 5 years and is granted when the trustee issues a notice of objection to the bankrupt being discharged with ITSA. The exact timeframe depends on the circumstances of the case.

A bankrupt may also seek to have their bankruptcy annulled. An annulment may occur where:

- (a) The trustee has sufficient funds to pay all of the bankrupts debts and all of the costs of the estate;
- (b) A *section 73* of the *Bankruptcy Act* proposal is accepted by the creditors of the estate (essentially this where all of the creditors agree to accept a lesser sum in full and final satisfaction of the debt); or
- (c) The bankrupt convinces the Court that the bankruptcy should never have been commenced.

Masons Lawyers have extensive experience in acting for both bankrupts and trustees in the bankruptcy process. Contact Masons Lawyers in either our Brisbane office 3117 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



3. What property is divisible in bankruptcy?

In Chapter 2 we set out the consequences of bankruptcy and gave a general overview of the bankruptcy process. The purpose of this chapter is to give a more detailed discussion as to what happens to the bankrupts' property.

Where a person is bankrupt their personal property is vested in their trustee. Vesting is the process in which legal and beneficial ownership of property is automatically transferred to a third party. Where bankruptcies are concerned the *Bankruptcy Act* provides that immediately upon the issue of a Sequestration Order that all of the property of the bankrupt vests in the trustee.

Where property is acquired after the person is bankrupt but before discharge only divisible property vests in the trustee.

Divisible property is defined broadly in the *Bankruptcy Act* and includes:

- (a) All property owned at the time of bankruptcy or acquired during the bankruptcy;
- (b) Any rights or powers over property that existed at the date of bankruptcy or during the bankruptcy;
- (c) Any rights to exercise powers over property;
- (d) Any property that vests because an associated entity received the property as a result of personal services supplied by the bankrupt; and
- (e) Monies recovered from an associated entity due to an increase in the net worth of the entity as a result of personal services supplied by the bankrupt.

The *Bankruptcy Act* also defines a broad range of property as non-divisible property. The purpose of non-divisible property is to allow the bankrupt to own certain property to continue with their lives and to allow themselves to rehabilitate to become productive members of society. These include (see *section 116* of the *Bankruptcy Act* for the full list):

- (a) property held by the bankrupt in trust for another person;
- (b) the bankrupt's household property that is:
 - (i) of a kind prescribed by the regulations (these include many items that a person needs to live); or



- (ii) identified by a resolution passed by the creditors before the trustee realises the property;
- (c) personal property of the bankrupt that has sentimental value for the bankrupt and is of a kind prescribed by the regulations and is identified by a special resolution passed by the creditors before the trustee realises the property;
- (d) the bankrupt's property that is for use by the bankrupt in earning income by personal exertion and does not have a total value greater than the limit prescribed by the regulations, is identified by a resolution passed by the creditors; or is identified by an order made by the Court on an application by the bankrupt;
- (e) property used by the bankrupt primarily as a means of transport, being property whose aggregate value does not exceed the amount prescribed by the regulations or, if before the trustee realises the last-mentioned property the creditors determine by resolution a greater amount in relation to that property, that greater amount.
- (f) policies of life insurance in respect of the life of the bankrupt or the spouse of the bankrupt whether the proceeds are received on or after the date of the bankruptcy;
- (g) the interest of the bankrupt in a regulated superannuation fund or a payment from such a fund received on or after the date of the bankruptcy, if the payment is not a pension within the relevant meaning;
- (h) any right to recover damages or compensation for personal injury or wrong done or in respect of the death of the spouse of the bankrupt or a member of the family of the bankrupt.

The question of what property is divisible property is sometimes not a simple question. As such you should ensure that you obtain proper advice as to whether you have a particular item that you believe should or should not be included in a your or a person's divisible property.

Our Insolvency law team has extensive experience in acting for bankrupt persons, creditors and trustees to ascertain whether or not property is divisible property. Contact Masons Lawyers in either our Brisbane office 3117 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



4. What will happen to the bankrupt's family home?

The effects on a family home are often the most important and concerning to a person who becomes bankrupt or may become bankrupt. It is important to note that a family home is not a protected asset and is one that forms part of a bankrupt's estate. This means that where a person becomes bankrupt they need to consider the consequences that this will have on their family home.

4.1 Consequences of joint ownership

Often a family home is owned by the bankrupt and their spouse. Where this occurs the trustee can insist on receiving 50% of the equity in the property. Upon bankruptcy where a property is owned as joint tenants, this is automatically severed, this means that if the bankrupt dies after the date of bankruptcy the other joint tenant does not automatically receive the property.

The equity in the property will be determined by the sale of the property, the payment of all secured debts and then dividing the remaining equity between the joint owner and the trustee of the bankrupt.

4.2 How is the equity realised?

Ordinarily the trustee will ascertain the value of the property so that the trustee is aware of the equity that remains in the property. The trustee would then ordinarily take the following steps:

- (a) Give the co-owner the opportunity to buy the estate's interest in the property;
- (b) If that is not possible, see whether the co-owner will join with the trustee to cooperatively marketing the property on agreed terms; or
- (c) The trustee can apply to the Court for an order appointing a statutory trustee for sale of the property.

Once the property is sold, the secured creditors and any service providers are paid the balance is distributed amongst the joint owner and the trustee of the bankrupt in the proportions in which they own the property.

Masons Lawyers have extensive experience in acting for both bankrupts and trustees in the sale of both family homes and other properties that form part of a bankrupt's divisible property. Contact us in either our Brisbane office 3117 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



5. Void transactions and Preferences in Bankruptcy

Upon appointment as a trustee, the trustee of a bankrupt's estate will investigate the affairs of the bankrupt to ascertain whether they believe that the bankrupt has improperly dissipated or removed assets that would have come under the trustee's control to be available for the bankrupt's creditors. The *Bankruptcy Act* may sometimes void these transactions and return them to the trustee or make a payment to the trustee for the property.

The purpose of these laws is to prevent a bankrupt from transferring property to defeat the creditor's ability to receive a dividend from the bankrupt estate. It is part of the role of the trustee to discover whether the bankrupt has attempted to divest assets in this manner. The powers given to the trustee to recover property generally relate to three types of transactions:

- (a) Undervalued transactions;
- (b) Transfers done with the intention to defat creditors; and
- (c) Preferences.

5.1 Undervalued Transaction

On occasion a debtor will attempt to divest their assets shortly before they become bankrupt by selling or transferring the assets to a family member or friend. Generally these transactions will be:

- (a) A sale of an item for less than the market value of the item – moving a valuable asset to another party;
- (b) A purchase of a product or service for greater consideration than it is worth – dissipating money to another party; or
- (c) The granting of a security over an asset for a past or invested debt.

These transactions may be voided by the trustee within 5 years of the date of the bankruptcy so long as they are truly undervalued.

There are certain exemptions to this general rule and the circumstances of each transfer will need to be examined to ascertain if the transfer is one that is void and should be wound back.

5.2 Transfers to defeat creditors

On occasion a debtor will enter into transactions that are primarily and blatantly used to protect assets from creditors. Where the intent of the



bankrupt is to defeat creditors these transactions may be voided by the trustee.

The important difference between a transfer to defeat creditors and an undervalued transaction is that there is no time limit within which a transfer to defeat creditors can be recovered. The trustee can void the transaction made at any time before the bankruptcy, as long the following conditions are met:

- (a) Property that probably would have become available to creditors, being made unavailable; and
- (b) The intention of making that property unavailable to creditors, permanently or temporarily.

5.3 Preferences

Under certain circumstances a trustee can seek to recover payments of money made to creditors of the bankrupt. As the name suggests a preference payment is a payment made to a creditor in preference to other creditors. The *Bankruptcy Act* allows a trustee to recover certain payments where the following conditions are met:

- (a) A transaction was entered into within 6 months from the date of bankruptcy;
- (b) The transaction was between the bankrupt and one of their creditors (even if other parties were involved);
- (c) It was entered into at a time when the bankrupt was insolvent;
- (d) The transaction gave the creditor an advantage over other creditors (preferential treatment); and
- (e) It did not involve protected property.

The question of determining whether a bankrupt has attempted to transfer property to defeat creditors, transfer assets at undervalue or make payments in preference to other creditors are complicated questions that will often involve a detailed assessment of the facts and circumstances surrounding the transaction.

Masons Lawyers Insolvency Law team has extensive experience in acting for both bankrupts and trustees to determine whether the transfer of property should be set aside. Contact us in either our Brisbane office 317 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



6. Additional consequences if you are a builder licensed under the Queensland Building Services Authority Act?

Builders licensed pursuant to the *Queensland Building Services Authority Act (QBSA Act)* face additional consequences to their ability to hold their building licence if they become bankrupt. It is important that they understand these consequences where they may become bankrupt so that you are prepared for the action taken by the Queensland Building Services Authority (**QBSA**).

If a licensed builder is declared bankrupt or the licensed builder is a director, secretary or influential person of a company that is wound up, the QBSA has the power pursuant to the QBSA Act to deem that an event has occurred pursuant to which they are deemed to be an 'excluded individual' pursuant to *section 56AC* of the QBSA Act (**an event**).

6.1 What are the consequences of this occurring with the QBSA?

Where one event has occurred the effect of this will be that the person will be an excluded individual for a period of 5 years unless they can make appropriate submissions to the QBSA to have them deemed to be a permitted individual. This application must be made to the QBSA within 28 days after they receive notice from the QBSA that the QBSA intends to deem the person an excluded individual.

Where a second or subsequent event occurs the person will receive a second or subsequent notice from the QBSA. The QBSA has the power to deem that person an excluded person for life. This means that they can never be a licensee or a director or secretary of a licensee company for the rest of their life. Once again the person will have 28 days from the date that they receive notice of the QBSA's intention to deem them an excluded individual, to make an application to the QBSA that they should be categorised as a permitted individual.

Where a person receives such an exclusion notice they should immediately contact your professional advisors so that steps can be taken to determine whether they should make such an application and to properly prepare the application on their behalf. There are a variety of factors which must be considered to comply with the requirements of the legislation and give the person affected the best chance of succeeding in the application.



6.2 If the QBSA refuses the application, what is the next step?

Where the QBSA decides that it will not categorise a person as a permitted individual, that person is may apply for a review of that decision through the Queensland Civil and Administrative Tribunal (**QCAT**).

The purpose of this application is for the QCAT member to conduct a fresh review of the matter to decide if the QBSA decision should have been to categorise the person as a permitted individual.

These are important and complicated applications and once again if they become necessary you need to instruct competent lawyers to act on your behalf in the application.

Masons Lawyers solicitors have extensive experience in acting for licensees making applications to be categorised as a permitted individual with both the QBSA and QCAT. Contact us in either our Brisbane office 3117 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



7. Conclusion

This e-book only covers a small range of the large variety of matters that need to be considered in relation to bankruptcy. It is a broad area of the law with many complicated and novel questions which require the right advice to ensure that all parties are properly protected.

A person being declared bankrupt has serious consequences to their ability to continue to function in society and trade with the others. Before a person becomes bankrupt there are a certain number of considerations that a person must make to ascertain the exact consequences for them of the process. Conversely before a creditor seeks to have a person declared bankrupt they must consider what they will achieve from the process and whether or not it is financially viable to do so.

The consequences on persons in specific industries such as the building industry can result in that person been excluded for life from being able to operate a business in their chosen field. Not only should these consequences be considered before a person becomes bankrupt but they should also be considered before a person starts a business.

At Masons Lawyers we have extensive experience in acting for a variety of different clients on general bankruptcy issues to specifics such as the consequences for builders and other industries. Contact us in either our Brisbane office 3117 3780, Caboolture office 5428 1111 or on our hotline 1300 000 LAW to discuss your requirements.



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