

# BANKRUPTCY

## Overview

A person who is insolvent must decide on a course of action that is acceptable to their creditors. Due to the personal nature of bankruptcy and the social stigma associated with it, many people are loathe to seek appropriate advice. This is in spite of the intention of the Bankruptcy Act 1966 (the legislation) to rehabilitate the debtor to allow them to make a fresh start.

## Who Can Become Bankrupt?

A person is bankrupt under the legislation (s.5 (1)) if they:

- Have a sequestration order made against them; or
- They have presented a debtor's petition.

A sequestration order bankrupts the debtor and places their property into the hands of a trustee. Under the legislation only a person who has the necessary connection with Australia can have a sequestration order made against them.

A deceased estate is also considered to be a person for legislative purposes.

## How Does A Person Become Bankrupt?

A person can become bankrupt voluntarily by presenting a debtor's petition or involuntarily by a creditor's petition. The creditor's petition seeks a sequestration order to be made against the estate.

A person who chooses the debtor's petition must lodge a statement of their affairs with the Official Receiver. It is also possible for the person to present a 'declaration of intention to present a debtor's petition' which gives a person seven days grace during which time they can seek alternatives with accounting and legal advisers. Certain debtors are excluded from making a 'declaration of intention'.

Under the creditor's petition, a court must be involved to obtain a sequestration order. To be successful in the application to the court the creditor must prove that:

- The debtor has committed an act of bankruptcy within six months of the presentation of the petition;
- The debtor had the necessary connection with Australia;
- The debtor owed at least \$2000 to the creditor; and
- The debt owed is a liquidated sum payable immediately or on a certain future date.

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An example of an act of bankruptcy is where the debtor assigns his property for the benefit of creditors generally.

### Trustee In Bankruptcy

Once a person has been declared bankrupt their estate is given to either the Official Trustee or a registered trustee in order to have them administer the estate. All property of the bankrupt is said to 'vest' in the trustee, including property that the bankrupt becomes the owner of after they have been declared bankrupt and before they have been discharged.

It is the trustee's responsibility to realise the estate's property and then distribute the proceeds amongst the creditors but to do so in the interests of both the creditors and the bankrupt and to ensure that it is done with the public welfare in mind as outlined in the legislation.

The trustee has extensive powers under the legislation to ensure that all available property is realised and distributed to creditors in accordance with the legislation. The trustee has the power to recover property that may have been assigned or sold to creditors or third parties in certain circumstances such as where the transfer was undervalued or was to defeat creditors.

### Property Available For Realisation

Although all the bankrupt's property resides or vests in the trustee there is certain exempt property. This type of property is almost a necessary part of living and earning a living. For example, there are necessary household items such as cooking utensils, TV etc, there is property used in earning income by personal exertion up to the value of \$3150 (20/3/08) and a means of transport such as a car up to the value of \$6300 (20/3/08). In addition to these examples life insurance policies fall into this exempt category.

### Distribution Of Estate

Once the estate's property has been realised then the trustee will discharge any debts incurred under the administration of the estate and distribute a dividend to creditors. Certain creditors will obtain a priority under the legislation as part of public policy, for example, an employee of the bankrupt who is owed wages is given a priority.

### Discharge From Bankruptcy

A bankrupt will be discharged three years after filing their state of affairs unless an objection has been lodged by the trustee. There are only certain grounds that a trustee can use to object to the automatic discharge of the bankrupt. They are outlined in s. 149D (1) of the legislation.

## Disclaimer

The legislation surrounding bankruptcy is complex. The intention of this article is to give the reader an overview of what happens in a bankruptcy but does not cover in detail the intricacies of the legislation. It is not legal advice and the circumstances of each individual must be assessed to ensure that the correct decisions are made. It is therefore imperative that professional advice is sought in the first instance.