



## BANKRUPTCY

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This article discusses bankruptcy generally, and how creditors can recover debts owed by taking bankruptcy proceedings against a debtor. It also discusses how a person becomes bankrupt and the consequences that follow.



Bankruptcy can occur by an order of the Court or voluntarily. Less commonly, bankruptcy can be applied for by the legal personal representative of a deceased person.

### A. BANKRUPTCY ORDERED BY THE COURT—CREDITOR'S PETITION

If a Creditor is owed a debt, they may seek to enforce the debt by taking bankruptcy proceedings against the Debtor at the Federal Court of Australia or the Federal Circuit Court of Australia. This may only be done when the debt owed is \$10,000 or more. There are a number of ways creditors can bankrupt debtors. The most common procedure would involve the following steps:

1. Obtaining a Court Judgment against the Debtor for the debt.
2. Creditor requesting the Australian Financial and Security Authority ("AFSA") to issue a Bankruptcy Notice based on the Court order obtained (the Court order must not be over six years old). The Bankruptcy Notice must be complied with within 21 days by the Debtor. In some cases, an extension of time to comply with the Bankruptcy Notice may be applied for by the Debtor by making an application to the Court.
3. If the Bankruptcy Notice is not complied with (this is known as an act of bankruptcy), then the Creditor can petition the Court to have the Debtor be made bankrupt. Before filing a Creditor's Petition, the Creditor should conduct a search of the National Personal Insolvency Index (NPII) to check that the Debtor has not already been made bankrupt. If a Creditor wants to appoint a private registered trustee to administer the bankrupt estate, the trustee's written consent must be obtained and served on the Debtor. Otherwise, the AFSA would be the appointed trustee by the Court.
4. Upon filing a Creditor's Petition at the Federal Court or the Federal Circuit Court, a copy of it would need to be sent to AFSA so that the NPII would be updated to show the Creditor's Petition. A hearing of the Creditor's petition would be held, where the Creditor would have to prove that the Debtor committed an act of bankruptcy (pursuant to Section 40 of the Bankruptcy Act 1966) within the six months prior to filing the petition. The Debtor would also be able to make a submission during the Court hearing.
5. If the Court is satisfied that an act of bankruptcy has been committed by the Debtor, it would issue a Sequestration Order. This Sequestration Order has the effect of making the Debtor bankrupt. Within two business days of the Order, a copy of it must be provided to AFSA together with the details of a private registered trustee (if one is appointed).

A Debtor may oppose a Creditor's Petition by filing grounds of opposition at least three days before the hearing of the petition. Grounds for opposition may include that the Debtor did not commit the act of bankruptcy as alleged (eg the Bankruptcy Notice was not served properly); the Debtor does not owe the amount claimed (eg the debt was repaid or the Court Judgment for the debt is being appealed); or an agreement has been made with the Creditor to repay the debt.

### B. PRIOR TO BANKRUPTCY

If the Debtor is struggling to pay their debt and looking to stop a Creditor from chasing the debt, there are a few things a Debtor can do prior to petitioning for bankruptcy. These options include: negotiating informal arrangements or formal debt arrangements (like a Debt Agreement or Personal Insolvency Agreement); or obtaining interim relief in the form of a declaration of intention to present a Debtor's petition, which stops creditors from taking debt enforcement action for a period of 21 days.

However, when these arrangements fail, bankruptcy proceedings could be commenced by either the Creditor or the Debtor.

### C. VOLUNTARY BANKRUPTCY—DEBTOR'S PETITION

If a Debtor is unable to pay their debts as they become due, and if no suitable repayment plan can be made with their Creditors, the Debtor may have to apply to become a bankrupt. Upon becoming bankrupt, almost all unsecured creditors cannot take any further legal



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action to recover the debts owed. This is done through lodging a Debtor's Petition for Bankruptcy. Approximately 80% of bankruptcies that happen in Australia occur through a Debtor's Petition for Bankruptcy.

Applications for voluntary bankruptcy must be lodged with the Australian Financial and Security Authority ("AFSA"). Documents to be lodged with the AFSA include the Debtor's Petition for Bankruptcy, a statement of affairs and an acknowledgement that the debtor has read the "prescribed information."

Once the Petition is lodged with the AFSA together with the relevant documents, an Official Receiver needs to accept the Petition and issue a bankruptcy number.

In some cases, the Official Receiver will not accept a Debtor's Petition for Bankruptcy where from the information provided, it is likely that the Debtor can pay their debts and are avoiding payment of them. When lodging the Petition, the Debtor should be present in Australia.

It should be noted that unlike a Creditor's Petition, there is no limit on the amount of debt owing before a Debtor's Petition of Bankruptcy may be filed.

### D. CONSEQUENCES OF BANKRUPTCY

Bankruptcy generally lasts for a period of three years (but can be extended to five or eight years in some cases). However, the bankrupt's name would be permanently recorded on the National Personal Insolvency Index, which can be assessed by the public upon payment of a fee.

Credit reporting agencies would also keep a record of the bankruptcy, normally for a period of seven years.

When a Debtor becomes bankrupt, a Trustee is appointed to administer the bankruptcy. The Trustee would try to pay the Debtor's creditors by:

1. Selling the Debtor's assets (some assets like ordinary household items and personal items are exempt)
2. Using the Debtor's income if above a certain threshold
3. Investigating whether property originally owned by the Debtor was transferred to another person for nominal consideration prior to their bankruptcy.

### E. BANKRUPTCY, INCOME AND EMPLOYMENT

Being bankrupt does not limit the amount that a person can earn. However, earning an income over a certain threshold will require the bankrupt person to make compulsory payments to the trustee. Compulsory income contributions are comprised of 50% of the amount earned over the income threshold. For example,

if the bankrupt person earns \$10,000.00 over the income threshold, he or she will have to pay \$5,000.00 to the trustee.

The current base income threshold is \$59,559.50 (after tax) if the bankrupt person has no dependents. A person is considered dependent under section 139K of the Bankruptcy Act 1966 if he or she resides with the bankrupt person and relies on them either wholly or partly for financial support. A person can determine the compulsory payments they would have to make via the income contributions calculator here (click): [Income contributions calculator \(afsa.gov.au\)](http://incomecontributionscalculator.afsa.gov.au).

During bankruptcy, a person can keep and save their income in their bank account (provided they do not have to make compulsory payments). Regarding employment, a bankrupt person is generally not allowed to become a company director. They can run their own business, but they may be subjected to restrictions

### F. DISCHARGE OF BANKRUPTCY

If a Debtor has been made bankrupt by a Sequestration Order or voluntarily, the Debtor will generally be automatically discharged from bankruptcy three years and one day from:

- a) when the completed Statement of Affairs has been accepted by ITSA (for bankruptcy made under a Sequestration Order); and
- b) when the Debtor's Petition and Statement of Affairs was filed (for voluntary bankruptcy).

### G. ANNULMENT OF BANKRUPTCY

Bankruptcy can be annulled (meaning cancelled) in certain circumstances. The three ways to get an annulment include:

- a) the Debtor paying their debts in full (including the Trustee's costs);
- b) coming to an arrangement with Creditors to pay less than the owed amount in satisfaction of the full debt; and
- c) via a Court Order.

If a bankruptcy is annulled, the public record would have a permanent record showing that the bankruptcy was annulled.

Comasters can help creditor clients to apply for a Sequestration Order, or help debtor clients defend a bankruptcy action.

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