Chapter 6: The consequences of bankruptcy: Part 3

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Content

Summary

There are many different consequences of bankruptcy. Some of the concepts are quite complicated. It is important to have a broad understanding of the principles and to be familiar with problems that might arise so that you know what questions to ask the client and when to seek more advice on their behalf.

This section is broken up into segments. Parts 1 â?? 5 covers:

1. What happens to debts?
2. What property is protected?
3. What property will be taken by the Trustee?
4. Whether the client has to pay income contributions and how much.
5. What other consequences there might be.

Financial counsellors should be aware of the content of all these parts at least in broad terms as they are relevant to all clients.

Parts 6 â?? 9 need only be referred to if they are relevant to your clientâ??s individual circumstances. They cover in order:

6. Small Business
7. Family Law
8. Gambling and hazardous speculation

9. Death

Introduction

Your client must understand the following potential impacts of bankruptcy before making an informed decision whether to go bankrupt:

1. **Debts** â?? will they go away?
2. **Assets** (past, present and future) â?? will the trustee in bankruptcy (â??the Trusteeâ??) take them? Can the Trustee undo past transactions and get at assets now owned by others? What about assets your client may acquire in the future?
3. **Income** â?? will the client have to pay a portion of their income towards their debts (â??income contributionsâ??) and if so, approximately how much?
4. What other limitations might there be on the clientâ??s life as a result of the bankruptcy?

These are all covered in this Chapter.

> **Note:** The same consequences apply when the client has been made bankrupt on a Creditorâ??s Petition, although in that case there is no decision for the client to make. You can refer to this Chapter to advise your client about what to expect during bankruptcy. You should also refer to the bankruptâ??s obligations in **Chapter 8**. If your client has very recently been made bankrupt and does not think this should have happened, refer to **Chapter 10** â?? A sequestration order has been made against my client â?? Is there anything he or she can do? Advise your client to seek urgent legal advice.

Part 3: Divisible Assets â?? What will the trustee take and sell?

Summary

All property of the bankrupt that is not protected (see Part 2 above) is divisible property that vests in the trustee from the date of commencement of the bankruptcy (see ss 5 and 116(1) of the *Bankruptcy Act 1966* (Cth) for the definitions of â??propertyâ?? and â??divisible propertyâ??). This includes property owned by the bankrupt at the commencement of the bankruptcy and any property acquired by the bankrupt between the commencement of the bankruptcy and discharge from bankruptcy (or annulment). It also includes any rights and powers in relation to that divisible property that would have been exercisable by the bankrupt if he or she had not become a bankrupt.

Generally speaking, divisible property can include many things but most commonly:

1. Vehicles (cars, boats, caravans, motorbikes, trailers, trucks, buses, vans);
2. Houses, flats and other real estate (including the bankruptâ??s share of property owned jointly with others);
3. Shares and other investment products;
4. Cash in a deposit account (or under the bed or buried in the chicken coop);
5. Registered (pedigree) animals (if their value if sufficient to justify costs of sale);
6. Insurance claim proceeds unless specifically protected (for example, life insurance paid after the date of the bankruptcy is protected) or indemnifying the loss of property that would itself have been protected;
7. Debts owed to the bankrupt.

The commencement of the bankruptcy and the date of the bankruptcy are not necessarily the same thing. The commencement of bankruptcy is up to six months prior to the presentation of the Debtorâ??s Petition or Creditorâ??s Petition, depending on the date of the earliest act of bankruptcy committed by the bankrupt in that period, known as the â??relation back periodâ?? (see **Chapter 10 for more information on acts of bankruptcy**).

Divisible property vests in the Trustee and the bankrupt can no longer deal with it. The Trustee has extensive powers to deal with, and sell, the vested property for the benefit of creditors and the costs of administering the bankrupt estate.

The Trustee has a choice whether to take possession and sell particular property, carry on the bankruptâ??s business (if any) in the short term to improve realisation value, bide their time to see if it will be worth selling the property in the future (for example, because there is the potential of an offer for the whole of the divisible property, which will provide a better price than selling the assets individually), or disclaim the property.

> **Note:** Clients with intellectual property rights or potential intellectual property rights (such as copyright and patents) should get specialist legal advice. Any income stream will definitely count towards assessing whether income contributions are payable, but a lump sum advance, for example, may vest in the Trustee.
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> **Note:** Where an insurance policy exists for the benefit of a 3rd party â?? such as the mortgagee bank in the case of home building insurance, or the creditor in the case of consumer credit insurance â?? then the proceeds of the claim must be paid to the relevant 3rd party (s 117). **More on insurance is found in Chapter 8.**

Complicated scenarios include:

1. Where property is security for a loan (such as a motor vehicle loan or home loan);
2. Where the property is owned jointly with one or more other persons;
3. Where the *legal* ownership of property and the equitable ownership may not be the same; (such as where a person puts a property they have largely paid for in someone elseâ??s name)

4. A combination of the above.

Generally speaking, the trustee will only take property where the bankruptâ??s share after deducting any loan will still leave a worthwhile return for the bankrupt estate. Co-owners will be given the opportunity to buy out the bankrupt or will be given the equivalent of the value of their share after any sale.

The Trustee is not limited in the timeframe in which they should realise vested property, though they must deal with it in such a way as to maximise returns for creditors and therefore assets should be sold as soon as possible. Just because the bankrupt has been discharged, does not mean that it is too late for the Trustee to take and sell vested property unless the bankrupt (or someone else) has arranged to buy back the bankruptâ??s share. Property which has not been disclosed to the Trustee can also be discovered and sold long after discharge.

The Trustee also has extensive powers to look into the past (that is, investigate the financial affairs of the bankrupt) and recover property from other people in some circumstances, usually because the bankrupt has (intentionally or unintentionally) shifted assets to other people when they would otherwise have been available for creditors. These are called antecedent transactions. They include (among others) preferential payments, undervalued transactions and transfers to defeat creditors.

Assets acquired during the period of bankruptcy (after-acquired property)

Non-protected assets acquired after the date of the bankruptcy and before the bankrupt is discharged will also vest in the Trustee and be available for distribution to creditors (unless that property is of the type exempted by s 116(2) â?? see **Chapter 6 Part 2**).

This means that if your client inherits money from a deceased estate, wins money, or is given money or property in the period of the bankruptcy, then that money or property will be taken by the Trustee as an asset of the bankrupt estate. Should the asset (including funds) be sufficient to pay out all the debts, the Trusteeâ??s fees and expenses, and interest on the debts up to the date of payment, the bankruptcy will be annulled, and the surplus will be returned to the bankrupt.

Clients should also be told that while they are allowed to accumulate savings from income earned during bankruptcy (provided they pay any assessed income contributions) any asset purchased with such savings, or invested in anything other than a savings account, will be considered after-acquired property and vest in the Trustee.

It is important to note that it is the date that the client acquires the interest in the property that is relevant, and the Trustee may still seek to get in property from the bankrupt estate after the bankrupt has been discharged.

Examples

1. A clientâ??s relative dies 6 months before she is discharged from bankruptcy. She does not receive the money from the will until 3 months after discharge. The inheritance still vests in the Trustee for the benefit of the bankrupt estate (unless all debts, interest and expenses have already been paid) because it is the date of death which is relevant.
2. A clientâ??s relative dies during bankruptcy and bequeaths the client their house but subject to the â??life tenancyâ?? of another relative. Whilst the house vests in the Trustee, the house cannot be sold by the Trustee until the life tenant dies or vacates the property, which may be many years after the client is discharged from bankruptcy.
3. A client has no real estate in his own name but applies for a property settlement from his ex de facto partner 6 months after discharge. The relevant relationship ended 18 months previously and the apartment they shared was purchased 6 years previously. If the court orders that the client should have a share in the property then that share will vest in the Trustee.

Sometimes clients will win, inherit or otherwise come into possession of more property or money than their debts ever amounted to. In such cases the bankruptcy may be annulled, but only if there is sufficient money to pay out the debts, any interest that would have been payable up to the date of payment, the Petitioning Creditorâ??s legal costs and the Trustees fees and disbursements. This can amount to a considerable amount more than the debts by the time the Trusteeâ??s expenses are paid, which is one of the reasons that going bankrupt should be given very careful consideration and the client given detailed information on the consequences of bankruptcy. More detailed information on the process of annulment is included in **Chapter 8**.

Houses and other real estate (including your clientâ??s mortgaged home)

Unlike motor vehicles, there is no concept of protected real estate unless it has been wholly, or substantially, purchased with the proceeds of a compensation pay out or other protected money (see **Chapter 6 Part 2 on protected property**). Any asset that is not listed in s 116(2) discussed in **Chapter 6 Part 2** will vest in the Trustee immediately upon bankruptcy (or upon the acquisition of the property if acquired after bankruptcy and before discharge). This means that the Trustee is the legal owner, and the bankrupt can no longer deal with the property in any way without the Trusteeâ??s permission. The Trustee **will sell** any real property worth sufficiently more than the balance of the secured loan (if there is one) and the cost of organising the sale.

It would be rare for an unencumbered house (i.e. a house with no mortgage over it) not to be sold by the Trustee, unless there are factors which would significantly affect its realisable value, for example the property is in a very remote area or in very poor condition. Similarly, it would be rare for a person to be considering bankruptcy if they owned unencumbered property, as usually it would be more beneficial for the person to sell the property and try to negotiate with their creditors prior to considering bankruptcy (though, of course, there will always be exceptions). A client who has been made bankrupt by a sequestration order, on the other hand, may have unencumbered property.

A key cause of complaints about bankruptcy (and bankruptcy assistance and advice) is the effect bankruptcy has on assets, particularly the bankruptâ??s home. Some bankrupts enter voluntary bankruptcy without advice and do not understand that in most circumstances they will not be able to keep their privately owned home. In rare cases, bankrupts who have received advice claim not to have been told about the impact on their home, or the effect it will have on other family members or associates with whom they jointly own property. Claims that the bankrupt did not receive adequate explanation of the treatment of after-acquired property in bankruptcy also occur.

It is very important that financial counsellors and other advisors always do three things:

1. Specifically ask the client whether he or she owns their own home, is buying their own home, or has any interest in any other assets (including real estate, shares or money in the bank etc). You should prompt the client to consider small shares in family owned property, or assets purchased in previous relationships. You should file note that you asked the question, and the clientâ??s response.
2. In the event that the answer is yes, you need to warn the client of the rights of the Trustee in relation to unprotected assets. You should file note your warning. Even if your client says no, you should tell them that this is very important because the Trustee will take control of the bankruptâ??s share of any property/asset automatically upon bankruptcy and may choose to sell that property for the benefit of the creditors (or ask co-owners to purchase the bankruptâ??s share). Clients may have genuinely forgotten something or could be withholding information. You must explain the consequences just in case.
3. Explain that any real estate, money or other assets inherited or otherwise acquired while bankrupt will also vest in the Trustee.

Example:

A client attended financial counselling to seek assistance to go bankrupt for substantial debts which he could not pay. The client had a number of meetings with the financial counsellor and was asked on 3 occasions whether he owned or has a share in any property. The client consistently said no. At the final appointment to complete the paperwork the financial counsellor asked the client whether he had ever been left money or property in a will. The client replied â?? *no, but I do get my fatherâ??s house when my brother who has a life tenancy dies*â??. This information changed the decision-making process of the client because his interest in his fatherâ??s house would vest in the Trustee (subject to the life tenancy) if he went bankrupt. This means that the house would have passed to the trustee for the benefit of creditors upon the death of his brother. The client decided to pursue other options to deal with his debts.

What if my client owns, or is buying, property with someone else?

Where your client owns property jointly with another person or other people (for example their spouse, de facto partner, other family members or someone unrelated), then the other owners will be affected by the clientâ??s bankruptcy. This is also true if the property is being paid off (such as a jointly owned home with a mortgage).

Unless the property is protected (see **Chapter 6 Part 2 on protected property**) then the Trustee will usually ask the co-owner(s) to buy out the bankruptâ??s share. There may be some negotiations about a fair market value and what constitutes the bankruptâ??s share, but generally speaking, if the co-owners are prepared to pay to obtain the entire interest in the co-owned property to the Trustee, then the bankruptâ??s share of the property will be transferred to them.

The co-owner(s) will also have to pay to execute the transfer and will be liable for any stamp duty payable in the relevant jurisdiction for transfers of that type. Where duty is payable it will be assessed regardless of any mortgage owed (the duty will be payable on the entire value of the property transferred â?? not just the equity). Whether stamp duty is payable will vary depending on the law of which State or Territory applies. For example, the *Duties Act* 2000 (Vic), for example, provides that a transfer from a trustee in bankruptcy to the spouse or domestic partner will not attract stamp duty if the property will be the principal place of residence of spouse or domestic partner (s 48).

In some cases, either the Trustee or the co-owners might argue that the legally owned shares do not reflect the true *equity* position of the parties. For example, the co-owners might want to argue that the bankrupt held his or her share on trust for them (or another third party, such as a child) or the Trustee may want to argue that the bankruptâ??s share is in fact greater than the share shown on the title because he or she paid for the entire purchase price, or previously transferred their share to a co-owner for less than what it was worth. More information about co-ownership and equitable ownership is found in the section titled: **Useful information about property ownership is highlighted below**. Where there is a dispute over the respective shares of the bankrupt and non-bankrupt owner, it is important to negotiate and bring any relevant information or evidence to the attention of the Trustee. The Trustee will usually be reasonable rather than undertake expensive litigation.

For information about transfers of property which may be challenged by the Trustee, refer to the section **Looking into the past â?? can the Trustee get at money or assets the bankrupt does not own at the date of the bankruptcy? below.**

Where there is negative equity and the co-owner cannot afford to buy out the bankruptâ??s share during bankruptcy (as a result of stamp duty and legal fees for example), either the former bankrupt or the co-owner may be able to buy the share back from Trustee on discharge. This is a high-risk strategy (in so far as a number of things can go wrong) and the co-owner should seek independent legal advice on this. The co-owner should always try to make an arrangement to buy out the trustee as soon as practically possible as the trusteeâ??s share may increase over time in line with the equity in the property.

Example

Janette owns a house as an investment property jointly with her mother and sister. This is her only asset. She lives in a rented apartment and the house is rented out. The investment property is worth approximately $450,000. There is a mortgage over the property of $300,000. Janette is going bankrupt because of a large number of credit card debts and a tax debt she incurred as a result of a business venture she has now abandoned. The Trustee will give Janetteâ??s mother and sister the opportunity to buy out Janetteâ??s share of the equity by paying the Trustee its market value, in this case approximately $50,000 (market value of $450,000 less the mortgage of $300,000 giving equity of $150,000 divided by 3 owners) provided the family members own the property in equal shares. If Janetteâ??s mother and sister are in a position to do this, they will need to also pay the legal costs of preparing and registering the transfer and they will pay stamp duty on $150,000 (Janetteâ??s share of the market value rather than the equity).

The consent of the mortgagee (lender) will be required as the house is the security for their loan and the lenderâ??s interest will be registered on the title. Consent will no doubt also be required as a condition of the mortgage. Janetteâ??s bankruptcy will not affect any of the borrowersâ?? rights and obligations under the existing mortgage, except that Janette would not be able to be pursued for any shortfall in the event of a default and undervalue sale. The bank could only take action under the mortgage if there is a default under the contract (such as failure to make the required repayments).

However, if Janetteâ??s mother and sister wished to borrow additional funds to pay out the Trustee for Janetteâ??s share, the bank could insist on refinancing the entire amount and will only do so if the mother and sister qualify for the loan (including having capacity to pay). Janette may continue to assist with paying the mortgage if she chooses to do so but she cannot accumulate any interest in (ownership of) the property while she is an undischarged bankrupt.

In the event there was no mortgage, then the Trustee would be claiming $150,000 rather than $50,000 and the stamp duty would remain the same.

Where the co-owners are unable or unwilling to purchase the bankruptâ??s share of the property, then the property will need to be sold so that the Trustee can be paid out of the sale proceeds. Should the co-owner(s) refuse to co-operate, or an agreement cannot be reached, the Trustee can take court action to seize and sell the property. This could be a costly exercise and co-owners would be well advised to avoid costly litigation if possible. The Trustee will also weigh up whether such action is likely to be fruitful for creditors given the costs involved and will only take action if a return is likely after expenses.

Without the co-operation of the co-owner(s), the Trustee will be forced to take action in Court (in NSW this would be the Supreme Court under section 66G of the *Conveyancing Act 1919* (NSW)) seeking an order allowing the Trustee to sell the property in the absence of the consent of the co-owners. It should be remembered, however, that the Trustee has a very long period in which to choose to take action against the property (**see the summary below)** . This means that even if the Trustee does not consider it worthwhile to take action now, a new assessment may be made in the future if the value of the property has increased and/or any mortgage secured over the property has been paid down.

Where a co-owner is particularly uncooperative and there is little equity in the property the Trustee may choose to disclaim the property (see later section on this topic). If no person claims an interest in the disclaimed property, the bankruptâ??s share in the property would pass to the State (or Territory). If a person claims an interest in the disclaimed property, such as a co-owner (or is under a liability not discharged in respect of the property) they may apply to the Federal Court to for a vesting order to vest the property in that person (s 133(9)). The Court may make such an order as it considers to be â??just and equitableâ??. Such interested parties would be unable to deal with the property without taking such action, as the interest of the State (the Registrar-General in NSW, for example) would be noted on the title.

Process in summary â?? where divisible property consists of land

1. The Trustee will claim the bankruptâ??s share in the land (usually based on legal ownership);
2. The co-owner(s) may make an opposing claim (on the basis of equitable principles) or family law orders;
3. Negotiations between any co-owner(s) and the Trustee; and
4. Either the co-owner(s) pay to acquire the bankruptâ??s interest in the property or the Trustee chooses to concede, sells the property, applies to the court for a statutory sale of the property, or disclaims the bankruptâ??s interest in the property.

Where your client has a mortgage over their home (jointly owned or otherwise) you should also read the following section.

Bankruptcy and home mortgages

Where property owned by a bankrupt is mortgaged, the Trustee may sell the property on behalf of the mortgagee with its permission (and the Trustee will be reimbursed for the costs and expenses of the sale only). The Trustee can still sell the property even without the mortgageeâ??s permission, but they must ultimately repay the mortgaged debt to the extent possible from the sale proceeds of the property. Any surplus amount from the sale of the property will be paid into the bankrupt estate.

It is becoming increasingly common for people with home mortgages and a large amount of unsecured debt, such as credit cards and personal loans to consider bankruptcy as an option, particularly if they have little or no equity in the property (where the market value of the property is less than or close to the amount owed under the mortgage). In some cases people will be happy to surrender their home or real estate to the mortgagee (home loan lender). In others, they may wish to remain in the home and keep paying the mortgage while bankrupt. This is possible, but it is a risky course of action, and sometimes gives rise to complaints about advisers, particularly when the Trustee claims an interest in the property a few years down the track.

When your client is considering bankruptcy in circumstances where they are paying off their home and have very little equity you should warn the client that the Trustee may elect to sell the property at any time during the bankruptcy should the equity position change significantly. Further, the Trustee can still do this after discharge unless a formal arrangement is made to â??buy backâ?? any equity in the property.

Generally, where there is little or no equity in the property, the Trustee informs the bankrupt(s) that they can continue to occupy the property on the clear understanding that they will be required to:

1. Maintain the repayments due under the mortgage; and
2. Pay the council and water rates as they become due and payable; and
3. Keep the property fully insured and properly maintained and kept in a good state of repair at all times; and
4. Accept that all payments in respect of 1, 2 & 3 above are considered by the Trustee to be in the form of an â??occupation feeâ?? â?? this means that paying the mortgage and maintaining the property will NOT create any interest for the bankrupt in the property, nor create any entitlement for reimbursement of such payments.

Furthermore, bankrupts are usually informed that they can â??buy backâ?? their interest in the property when they are discharged from bankruptcy. In the case where the Trustee has lodged a caveat to protect the Trusteeâ??s interest in the property (instead of becoming registered on the title in place of the bankrupt) the Trustee will exchange a Withdrawal of Caveat for a bank cheque for the agreed â??purchase priceâ??. Consequently, as the Trustee has not legally transferred the title there is no conveyance of the property, no stamp duty is payable in that instance (however, advice from a taxation specialist should be obtained in these instances). On the other hand, if the Trustee had become registered on the title in place of the bankrupt, then there would be a transfer of title from the Trustee to the former bankrupt in which case, stamp duty would be payable. Normally, Trustees lodge a caveat on the title in the first instance and only become registered on the title where there is a sale to a third party.

Clearly there is a risk inherent in this process that these arrangements will not play out as planned and the property will have to be sold after all. Specifically:

1. Circumstances may change so as to mean that there is sufficient equity in the property to justify its sale by the Trustee for the benefit of the creditors.
2. The bankrupt(s) may not have sufficient funds to acquire the equity in the property upon discharge.
3. The bankrupt may not be able to maintain the mortgage, rates, insurances etc and the home may be repossessed.

In an attempt to circumvent these problems, some Trustees and bankrupts are coming up with creative arrangements whereby there is an attempt to settle the arrangements between the parties prior to the bankruptâ??s discharge, or even before the bankruptcy has even commenced. AFSA has previously warned about the problems associated with attempts to allow a bankrupt to purchase their equity in a property prior to discharge â?? any property transferred to the bankrupt will automatically vest straight back in the Trustee as after-acquired property even if it has been paid for with income available after all contributions have been made.

Some arrangements involve third parties such as family members purchasing the equity from the Trustee. In some cases, there is no equity at all, and the payment made is effectively paying the trustees fees for an otherwise â??emptyâ?? estate. An arrangement to purchase the equity by a third party may be perfectly valid, however a related agreement involving the promised transfer of the property back to the bankrupt runs the risk of the bankruptâ??s rights simply vesting back in the Trustee.

Financial Counsellors should not attempt to advise any client in relation to such an arrangement. There are risks and uncertainties for all parties and the arrangements appear to attempt to circumnavigate some of the basic principles of bankruptcy. Bankrupts and â??purchasersâ?? should be very cautious of entering into such arrangements and should obtain independent legal advice from a solicitor well versed both in bankruptcy and real property law and practice. Preferably, if there is no equity in the property the bankrupt should simply inform the Trustee that they wish to buy back their interest in the property upon their discharge from bankruptcy and start putting money aside for this purpose.

Resulting trusts

A resulting trust depends on the intention of the parties at the time they purchased or otherwise acquired the property. A resulting trust may also be found to exist where one party has transferred property or a share in a property to another person. The law of equity says that where one party provides all of the purchase money but the property is put in two names, then there is a presumption that the person who provided no money for the acquisition of the property holds their share of the property in trust for the person who paid. Similarly, if both parties have provided the purchase money but in unequal shares, then the party who provided the least amount holds part of their legal share on trust for the other party reflecting the proportions actually paid.

This presumption can be overturned by evidence of the partiesâ?? actual intentions at the time. The presumptions may also be altered as a result of the relationship between the parties. The â??presumption of advancementâ?? as it is usually referred to, assumes that people in certain circumstances intended a gift to the other party unless the evidence shows otherwise. For example, a father placing a property in the name of a child has been presumed to be making a gift, and in the past, a husband to a wife, or intended wife. These presumptions are not set in stone and may change with the times â?? for example in one case the majority of judges in the High Court found that the presumption of advancement did not apply to de facto relationships whereas one judge thought that it could, and another was of the view that the presumptions had no place whatsoever in modern property law (see *Calverley v Green (1984) 155 CLR 242).* The High Court has also recently decided on the issue of resulting trusts in *Bosanac v Federal Commissioner of Taxation (2022) HCA 34.*

More recently, the High Court also decided that when married spouses placed property in joint names (as joint tenants) then there is a presumption that the property is owned on a 50/50 basis unless the contrary can be clearly established by evidence of their actual intentions at the relevant time (see *Cummins v Cummins (2006) 227 CLR 278)*. This principle does not affect the powers of the Family Court to alter interests in property according to the contributions and needs of the parties and their children under the *Family Law Act* 1975.

Note. The non-bankrupt owner in the case of tenants in common will have some difficulty asserting that they have a greater than 30% share in the property on the basis they have contributed more than 30% of the acquisition cost of the property, because the extent of their ownership is designated on the title (reflecting the parties clear ownership intentions at the time). However, they may be able to lodge a proof of debt as a creditor in the bankruptcy. The Trustee on the other hand may in some circumstances assert the bankrupt has a greater share than that reflected on the title.

Constructive trusts

Constructive trusts have been implied by the courts in circumstances where it has been considered unconscionable to allow one party to benefit from the contributions of another. This principle can apply to a variety of situations including business ventures, but it was commonly used to allocate property interests upon the breakdown of de facto relationships prior to law governing de facto relationships being enacted by the various state Parliaments. Prior to the 2005 amendments to the Family Law Act 1975, which allowed the family court to divide property which had already vested in a trustee in bankruptcy, constructive trusts were often argued to prevent the Trustee taking property that might otherwise have been dealt with under a property settlement.

A constructive trust was usually found in circumstances where a â??joint ventureâ?? was thwarted by no fault of the parties concerned, leaving them in a situation where one would benefit from the contributions of another in circumstances neither ever intended. For example, in one case a de facto couple purchased a property with the woman paying over 90% of the purchase price and placed it in joint names because the man was intended to make considerable improvements to the property at his own expense and with his own labour. The relationship broke down before the improvements were ever made. The court found that there was no resulting trust in proportion to the initial contributions because there was clear evidence that the couple consciously placed the property in joint names intending to contribute to the venture in differing ways. There was, however, a constructive trust because it would be unconscionable to allow the man to benefit from the womanâ??s much greater contribution. Accordingly, upon the sale of the property, each would recover their contribution first and then any additional proceeds should be split 50/50 as intended by their original joint venture.

Given that the Family Law Act 1975 (Cth) now provides a statutory regime which provides a clear framework for dividing property between both married and de facto couples, and that regime is still accessible after property has vested in the Trustee (see **Family Law and bankruptcy in Chapter 6 Part 7**), it is unlikely that these equitable rules will be as relevant as they have been in the past. They may still have relevance in circumstances where the co-owners are not and have never been married or de facto spouses. The trustee may also appeal to the above principles to assert that a bankrupt has an equitable share in a property owned by someone else such as their spouse (or greater equitable share than on the title in the case of co-ownership) in circumstances where there are no family law property proceedings between the parties. This would only be likely to occur if the bankrupt has made significant and clearly traceable contributions to the purchase or improvement of the property, and there is sufficient equity to make any proceedings worthwhile.

A Trustee can also rely on ss 139DA and 139EA of the *Bankruptcy Act* to argue that the bankrupt has made contributions to allow the acquisition of property, or substantially increase its value, to establish an interest larger than the bankruptâ??s ownership as reflected on the title, or even an interest in a property entirely in another partyâ??s name. Such contributions would need to have been substantial for a Trustee to risk the costs of pursuing such an application.

Co-owners of property should always seek independent legal advice if another co-owner becomes bankrupt. Similarly, where a party claims to have made a significant contribution to the purchase or improvement of a property legally owned by a bankrupt, then they should also seek legal advice to determine whether they can claim an interest in the property against the Trustee. When the non-bankrupt owner is a spouse or de facto spouse, he or she needs urgent family law advice â?? **see Chapter 6 Part 7: Family Law and bankruptcy.**

If you are assisting the bankrupt, you cannot also assist any non-bankrupt co-owner. If your client is a co-owner of property with another person who is bankrupt, or likely to become bankrupt, then you should also refer your client for specialist legal advice.

Property outside Australia

Divisible property under Australian bankruptcy laws is not limited to property in Australia. Clients who come from other countries may own, or inherit, property in their country of origin.

If the country has similar bankruptcy laws and is one of the small number of prescribed countries listed in s 29(5) of the *Bankruptcy Act* and Regulation 7 of the *Bankruptcy Regulations* (for example, Canada, the UK, NZ, the US and Singapore), the Trustee is able to claim and sell the property if it is commercially viable to do so with the assistance of the equivalent court in the foreign country. If it is in any other country, it is difficult if not almost impossible for the Trustee to sell the bankruptâ??s property. However, in some cases, the Trustee may direct the bankrupt to sell their overseas property and pay the net proceeds to the Trustee. If the bankrupt refuses to do so, the Trustee can take contempt action against the bankrupt. In some cases, there may also be practical difficulties transferring the money out of the other country.

Disclaiming contracts and property

Sometimes the Trustee will not be interested in a particular piece of vested property or particular contractual rights and obligations. The Trustee can disclaim property if the property is unsalable, and/or the costs of holding onto the property or selling the property exceed the value of the property to the bankrupt estate. The usual example of this is when there is estimated to be little or no equity in the property after taking into account the amount owed to the mortgagee, charges such as rates, holding charges such as insurance and the costs of sale. However, the Trustee will usually refrain from disclaiming the bankruptâ??s residence (unless there is no equity and particularly intractable co-ownership issues). Another common example might be a lease arrangement where the costs of maintaining the lease are worth more than its value to a potential purchaser.

The reason a Trustee disclaims a contract or property is to avoid personal liability in respect of the property if there is no benefit for the bankrupt estate. For example, if the Trustee didnâ??t insure the house and it was subsequently destroyed, then he or she could be held liable for the loss by the mortgagee because the Trustee effectively steps into the shoes of the bankrupt.

A disclaimer in relation to property or a contract has the effect of operating to bring to an end the rights and interests of the bankrupt in respect of the property and crystallises or fixes the liabilities of the bankrupt in respect of the property. A disclaimer also discharges the Trustee from all personal liability as from the date when the property vested in the Trustee, usually the date of bankruptcy. However, the disclaimer does not affect the rights or liabilities of another person.

The disclaimer must be in writing and served upon each person who, to the knowledge of the trustee, has an interest in the property being disclaimed (and in the case of a contract, any person who is entitled to a benefit of, or subject to a burden or liability under, the contract). Where the Trustee has not disclaimed property, they may be required to make a decision where a party interested in the property of the bankrupt applies in writing setting out their interest in the property and requiring the Trustee to decide whether to disclaim within 28 days of the notice being provided. If the Trustee fails to disclaim the property within that period (although, they may extend the period by application to the court), the Trustee cannot disclaim and, in the case of a contract, are deemed to have adopted it (see s 133(6)).

What happens after the property is disclaimed?

In most cases the property reverts to the person with the next best interest. In the case of land in NSWs, for example, the Registrar General on behalf of the State of New South Wales becomes the legal owner of the property subject to the disclaimer. It is then up to the person claiming an interest to apply to the Federal Court to have the property registered in their name.

Looking into the past â?? can the trustee get at money or assets the bankrupt does not own at the date of the bankruptcy?

In many ways bankruptcy does not begin neatly upon the date your client goes bankrupt and end on the day of discharge. The Trustee has extensive powers to look backwards into the bankruptâ??s affairs to seek funds and assets which may have been transferred in the past, depending on the circumstances. The Trusteeâ??s rights to recover property also extend beyond discharge â?? provided the property vested in the Trustee prior to discharge (s**ee the summary below).**

The Trustee can challenge transactions which were perfectly legal at the time they occurred but have now taken on a different characterisation (retrospectively) as a result of the bankruptcy. In some cases, they may be transactions which were clearly arranged to prevent money and assets being available to creditors. In others they may have been normal acts of generosity or familial support which are considered (by law) unfair to creditors who are now being asked to forego debts which they are legally owed.

The Trustee can challenge transfers of property or money made in the years leading up to the bankruptcy under the following rules or principles:

1. relation back
2. preferential payments
3. undervalue transactions
4. transfers to defeat creditors
5. superannuation payments to defeat creditors.

Superannuation is usually protected but not if payments have been made to defeat creditors. Where the Trustee is of the view that the bankrupt has been making extra superannuation payments in anticipation of becoming insolvent then he or she may take action to recover these extra payments for the benefit of creditors. This is covered earlier in **Chapter 6 Part 2 â?? Protected Property,** in the section on **Superannuation and bankruptcy**.

Relation back

The bankruptcy does not necessarily commence on the date of the presentation of the Debtorâ??s Petition, or the date of the sequestration order made by the court. A variety of time limits apply up to 6 months prior to the presentation of the first Creditorâ??s Petition (where there was a Creditorâ??s Petition) or in the absence of any Creditorâ??s Petition, up to 6 months prior to the presentation of the Debtorâ??s Petition â?? **see the summary below.**

This means that any property or funds owned by the bankrupt at the time of the commencement of the bankruptcy will vest in the Trustee even though they may no longer be owned by the bankrupt at the date of the bankruptcy. Accordingly, in some circumstances a transfer of property may be void against the Trustee, which means that it is as if the transaction never occurred and the property vests in the Trustee upon bankruptcy regardless of the transfer.

It also means that the time limits for undervalue transactions run further back than would otherwise be the case because the starting point for counting backwards to determine whether a transaction is potentially void against the trustee is the commencement date rather than the date of the bankruptcy.

The Bankruptcy Act provides for a number of defences to protect those persons who have acquired property from a debtor prior to bankruptcy, in the ordinary course of business, and paid the prevailing market value for the property.

Preferential payments

Where a creditor has accepted payment (or a transfer of property) in the period immediately prior to the bankruptcy they may be vulnerable to having the money taken back by the Trustee as a preferential payment (section 122) â?? again a variety of periods apply of not more than 6 months prior to the presentation of the first Creditorâ??s Petition or the presentation of a Debtorâ??s Petition where there was no Creditorâ??s Petition â?? **see the summary below**. The creditor can resist such a claim by the Trustee by establishing that:

1. the transfer or payment occurred in the ordinary course of business
2. for market value
3. a payment of the debtor made under a maintenance agreement or maintenance order
4. a transfer of property under a debt agreement
5. where the creditor did not know, or have reason to suspect, that the debtor could not pay his debts as they fell due, and that the payment (or transfer of property) would give the creditor preference, priority or advantage over other creditors.

The requisite knowledge or suspicion of the debtorâ??s insolvency can be inferred from the circumstances.

Where the creditor repays the money or property to the Trustee by way of recovery of a preferential payment, the creditor can then lodge a proof of debt for the amount owing prior to the payment or transfer being made.

Undervalue transactions

A transfer of money or property may be void against the Trustee because the person who received the money or property did not give payment (or anything else of equal value) in return or gave consideration of less value than the market value of the property (s 120). A typical example is where a husband transfers his share of their jointly owned property to his wife for a nominal amount like one dollar. The Trustee will request the wife to pay the Trustee the actual market value of the husbandâ??s half interest in the property or transfer back the husbandâ??s half interest to the Trustee. If the wife transfers back the husbandâ??s half interest, the Trustee must pay the wife the one dollar she paid.

The circumstances in which a transaction may be *v*oid against the Trustee as an undervalue transaction are as follows (subject to the exceptions which follow):

1. There is no consideration given for the transfer by the person who received it (consideration usually means payment but may include other property or rights given in return), or the consideration given was worth less than the market value of the property at the relevant time. A common example is where a relative pays out the existing mortgage and the house is transferred to them, but they do not pay the bankrupt for the bankruptâ??s net equity in the home (that is the difference between the market value of the home and the mortgage payout amount); and
2. The transaction took place in the five years prior to the commencement of the bankruptcy.

However, where the money or property was transferred to a person who was NOT a relative or related entity of the bankrupt, then the transfer will not be void against the Trustee where:

1. It occurred more than 2 years prior to the commencement of the bankruptcy; and
2. The bankrupt was solvent at the relevant time.

Where the money or property was transferred to a person who was a relative or related entity of the bankrupt, then the transfer will not be void against the Trustee where:

1. It occurred more than 4 years prior to the commencement of the bankruptcy; and
2. The bankrupt was solvent at the relevant time.

A transaction is not void against the trustee if is payment of tax due to the government or a transfer made pursuant to a maintenance agreement or order (including assessments under the *Child Support (Assessment) Act 1989*)).

> **Summary â?? undervalue transactions**
>
> Property (or funds) given away for no consideration, or less than market value, in the 5 years before bankruptcy unless:
>
> 1. Where a relative or related entity:
>   1. It was more than 4 years ago AND
>   2. The bankrupt was solvent at the time of the transaction.
> 2. Where not a relative or related entity:
>   1. It was more than 2 years ago AND
>   2. The bankrupt was solvent at the time of the transaction.

There is a presumption of insolvency, which can only be rebutted by evidence, if the bankrupt has not kept adequate accounts or records (or has since destroyed or lost them).

Some things are defined by the *Bankruptcy Act* as having no value as consideration for a transfer, for example:

1. love and affection
2. being a relative of the transferee
3. a promise to marry the transferee
4. a promise to allow the bankrupt to live in the property by a spouse or de facto partner, or ex-spouse or de facto partner.

Transfers to defeat creditors

Transfers of property or payments of money can also be void against the Trustee where it is found that the transaction was intended to defeat creditors (s 121). The test is whether the transferorâ??s main purpose in making the transfer was:

1. To prevent the transferred property from becoming divisible among his or her creditors; or
2. To hinder or delay the process of making property available for division among his or her creditors.

There is no time limit to how far back the Trustee can go to challenge a transaction of this nature â?? a transfer of property recoverable under section 121 may have been made at any time before the date of bankruptcy. However, it can be assumed that the further back the transaction, the more difficult it will be for the Trustee to produce adequate evidence to challenge the transaction.

The test for whether there is a transfer to defeat creditors is a subjective test in so far as it is the bankruptâ??s main purpose in making the transfer that matters. However, the Act also provides that the main purpose will be taken to be one or both of (i) or (ii) above if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent. Other evidence can also be used to demonstrate the main purpose (it does not have to be imminent insolvency).

There is a presumption of insolvency, which can only be rebutted by evidence, if the bankrupt has not kept adequate accounts or records (or has since destroyed or lost them).

A transaction will not be void against the Trustee if consideration of at least the market value of the property has been given by the transferee AND the person who received the money or property did not know, or could not have reasonably inferred, that the bankrupt was trying to defeat his or her creditors or was about to become insolvent.

A transaction is not void against the Trustee if it is payment of tax due to the government or a transfer made pursuant to a maintenance agreement or order (including assessments under the *Child Support (Assessment) Act 1989*)).

Summary â?? transfers to defeat creditors

Main purpose in making the transfer was:

1. To prevent the transferred property from becoming divisible among his or her creditors; or
2. To hinder or delay the process of making property available for division among his or her creditors.

There is no time limit â?? the Trustee can look back to transactions at any time prior to the date of bankruptcy.

It can be assumed to meet the test if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor **was, or was about**

to become, insolvent.

Other evidence of intention can also be used.

How far back can the Trustee look to claw back property for the bankruptâ??s estate?

<u>In all circumstances</u> of bankruptcy below:

1. Undervalued transactions (s 120)
    1. 5 years before the commencement of the bankruptcy and ending on the date of the bankruptcy. But not if more than 4 years ago where the transferee is a relative or other related entity, and the bankrupt was then solvent; or more than 2 years ago where the transferee was not a relative or other related entity, and the bankrupt was then solvent.
2. Transfers to defeat creditors (s 121)
    1. No time limit.

1.Circumstances of Bankruptcy: Creditorâ??s Petition

1. Commencement of bankruptcy and relation back period for divisible property (s115)
    1. First act of bankruptcy in the 6 months prior to the Creditorâ??s Petition (usually the expiry of a Bankruptcy Notice)
2. Period for preferential payments (s 122)
    1. 6 months prior to the presentation of the Creditorâ??s Petition
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Creditorâ??s Petition

2.Circumstances of Bankruptcy: Debtorâ??s Petition accepted by the Official Receiver under a direction of the court

1. Commencement of bankruptcy and relation back period for divisible property (s 115)
    1. Time specified by the court as the commencement of bankruptcy
2. Period for preferential payments (s 122)
    1. Time specified by the court as the commencement of bankruptcy
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Debtorâ??s Petition

3.Circumstances of Bankruptcy: Debtorâ??s Petition presented when at least one Creditorâ??s Petition was pending against the Petitioning Debtor (whether alone, as a member of a partnership or as a joint debtor), and accepted by the Official Receiver without a direction from the court

1. Commencement of bankruptcy and relation back period for divisible property (s 115)
    1. Time of the commission of the earliest act of bankruptcy on which any of the Creditorâ??s Petitions were based (usually the expiry of a bankruptcy notice)
2. Period for preferential payments (s 122)

    1. Time of the commission of the earliest act of bankruptcy on which any of the Creditorâ??s Petition was based
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Debtorâ??s Petition

4.Circumstances of Bankruptcy: Debtorâ??s Petition presented when no Creditorâ??s Petitions were pending but the debtor had committed at least one act of bankruptcy in the past 6 months, and accepted by the Official Receiver without a direction from the court

1. Commencement of bankruptcy and relation back period for divisible property (s 115)
    1. Time of commission of the earliest act of bankruptcy within the 6 months before the Debtorâ??s Petition was presented
2. Period for preferential payments (s 122)
    1. 6 months before the presentation of the Debtorâ??s Petition
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Debtorâ??s Petition

5.Circumstances of Bankruptcy: Debtorâ??s Petition presented when no creditorâ??s petitions were pending and the debtor had not committed any act of bankruptcy in the past 6 months, and accepted by the Official Receiver without a direction from the court

1. Commencement of bankruptcy and relation back period for divisible property (s 115)
    1. Time of presentation of the petition
2. Period for preferential payments (s 122)
    1. 6 months before the presentation of the Debtorâ??s Petition
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Debtorâ??s Petition

Circumstances of Bankruptcy: Composition or arrangement under Part IV Division 6 or Part X

1. Commencement of bankruptcy and relation back period for divisible property (s 115)
    1. First act of bankruptcy in the 6 months preceding the application for the sequestration order
2. Period for preferential payments (s 122)
    1. 6 months before the presentation of the Debtorâ??s Petition
3. Period for repaying proceeds of creditorâ??s execution (s 118)
    1. 6 months prior to the presentation of the Debtorâ??s Petition

How long does the trustee have to make a claim on property?

As detailed below, the trustee has a maximum of 20 years in which to make a claim against property owned at the time of the bankruptcy, transferred prior to the bankruptcy in the circumstances referred to above, or acquired during the period of bankruptcy. When the

Trustee does not make a claim within the period below (or extend the period by written notice in cases where this is provided for), then the property re-vests in the bankrupt or any other third party claiming through the bankrupt â?? for example the beneficiary under a will).

Circumstances and relevant Time Limits

1. Actions to recover property from other parties allegedly transferred by the bankrupt for less than market value
    1. 6 years from the date of the bankruptcy
2. Actions to recover property from other parties allegedly transferred to defeat creditors
    1. Unlimited
3. Actions to recover preferential payments
    1. 6 years from the date of the bankruptcy
4. In all other cases
    1. 20 years

When does property re-vest in the bankrupt?

1. For property disclosed in the bankruptâ??s statement of affairs **and** For property acquired after bankruptcy that is disclosed to the trustee in writing within 14 days of the bankrupt becoming aware of it and prior to discharge:
    1. 6 years after discharge unless the trustee extends the period in writing prior to the end of this period for up to 3 years or 3 years from a specified event (there is no limit to the number of extensions).
2. For property acquired after bankruptcy and not disclosed until after discharge but within 14 days of the bankrupt becoming aware of it:
    1. 6 years from disclosure to the trustee unless the trustee extends the period in writing prior to the end of this period for up to 3 years or 3 years from a specified event (there is no limit to the number of extensions).