

Chapter 6: The consequences of bankruptcy: Part 4

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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 – 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 – 9 need only be referred to if they are relevant to your client'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:

- **Debts** – will they go away?
- **Assets** (past, present and future) – will the trustee in bankruptcy ('the Trustee') 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?
- **Income** – will the client have to pay a portion of their income towards their debts ('income contributions') and if so, approximately how much?
- What other limitations might there be on the client'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 Creditor'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 bankrupt'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** – A sequestration order has been made against my client – Is there anything he or she can do? Advise your client to seek urgent legal advice.

Part 4: Income contributions – What happens to money I earn while bankrupt?

Summary

There are two ways in which the Trustee can obtain funds for the bankrupt estate:

- realising divisible property as covered in **Chapter 6 Part 3**, and
- income contributions from the bankrupt between the date of the bankruptcy and discharge.

In order to be required to pay contributions the bankrupt must earn above a certain threshold

amount. This amount varies according to the number of dependents maintained by the bankrupt.

In brief, the bankrupt must pay the Trustee half of any money earned *above* the relevant threshold. [For current income thresholds refer to the indexed amounts in the AFSA website.](#)

It can be difficult to work out what might be counted as income, particularly if the bankrupt has complicated personal and working arrangements. For example, the use of a car or house could be deemed income for the purpose of calculating income contributions. The Trustee can investigate the bankrupt's affairs and adjust the income used to calculate income contributions if the Trustee has reason to believe that the bankrupt is not fully declaring his or her income. The bankrupt has the right to apply for a review of that decision.

It is very important that the bankrupt declares his or her income to the Trustee and keeps the Trustee informed of any significant changes in income throughout the bankruptcy. Failure to do so is a breach of the *Bankruptcy Act* and can lead to significant arrears when the amount of the income contributions is adjusted later (when proof of actual income for the period is supplied or investigation uncovers additional income).

If the bankrupt fails to make assessed income contributions, the Trustee has a number of options for collecting arrears, including objecting to the bankrupt's discharge from bankruptcy, garnisheeing the bankrupt's wages or bank account, employing the supervised account regime under the Bankruptcy Act, or obtaining a court judgment and enforcing it in the usual way.

Income contributions

A bankrupt is required to pay contributions towards the bankrupt estate if they earn income above the relevant threshold amount during bankruptcy. The amount required to be paid will be assessed from the income earned in this period, but the liability to pay the assessed amount continues beyond the period of the bankruptcy until the assessed amount has been paid in full.

Note: Often your new client will ask you 'How much income can I earn when I go bankrupt, because I have heard that I will not be allowed to earn more than a certain amount?' This is a misconception. There is no limit to the amount a bankrupt can earn – the required contributions simply increase as the income increases.

In short, the amount payable is 50% of the amount of after-tax income earned above the relevant threshold, in any given year of bankruptcy (or a proportional amount for any lesser period). For example, if a person's after-tax income is \$72,000 and the applicable threshold is \$60,000, the contribution payable would be \$6,000 for that year, being 50% of the \$12,000 difference between the two amounts.

The assessment of the bankrupt's liability for income contributions is done on a yearly basis, which is known as a Contribution Assessment Period (CAP). Accordingly, there will be three CAPs in the normal three-year period of bankruptcy.

The detail, however, such as what is counted as income, or which threshold applies is much more complex.

Note: for more information on any aspect of income contributions see the [Official Trustee Practice Statement 1 Income Contributions last updated 1 July 2021, available on the AFSA website](#). This area can be complicated for some bankrupts with complex arrangements and there is no room to cover all the possible contingencies in this toolkit.

Do I really need to work this out for my clients?

While it is not necessary to perform an exact calculation of your client's likely contributions, it is wise to at least try to approximate whether your client will need to pay contributions based on their current and likely income, and if so, how much, as part of the decision-making process. It is clearly an important potential consequence your client needs to consider. At the very least a pre-assessment of contributions can prevent nasty shocks and complaints against your service when the contributions are later assessed by the Trustee. It may also assist clients who have a moderate to high income to reconsider their other options when they have been reticent to do so.

Case example

A client had been left exposed to huge joint debts by the actions of her ex-partner who has now fled the country. She has a high income (\$90,000) and a salary sacrifice arrangement (\$15,000) in place. She is unable to meet her debts as they fall due and has insufficient funds after meeting living costs, the cost of educating her children, rent and her car loan to make any significant contribution to her liabilities. She needs the vehicle to be able to work. The equity on the car loan is under \$4,000 and without her other debts she can just maintain the car loan.

The client was advised of the contribution rule and the impact of grossing up the salary sacrifice on the assessable income for the purposes of the threshold. She could then check whether she will be able to continue to pay the car loan and her other expenses. She can also determine how much she is likely to pay in total

over the period of her bankruptcy in order to more accurately compare this to any other available arrangement.

The relevant income threshold

The base income threshold amount (BITA) per annum is the applicable threshold for a person with no dependants. For the current amount for both the BITA and the actual income threshold amount (AITA) [check the current thresholds in the indexed amounts on the AFSA website.](#)

If a bankrupt has dependants, then the AITA is defined as (see s 139K):

1. No dependants, then the BITA
2. One dependant, then the BITA plus 18%
3. Two dependants then the BITA plus 27%; or
4. Three dependants then the BITA plus 32%; or
5. Four dependants then the BITA plus 34%; or
6. Where more than 4 dependants, then the BITA plus 36%.

All threshold amounts are stated per annum. If a contribution assessment period of less than 12 months applies, then the threshold applies pro rata. These amounts are indexed twice yearly in March and September, so [it is important to check the AFSA website to obtain the current amounts.](#)

What is counted as income?

Income is defined very broadly and includes anything that would, within the ordinary meaning of the term, be defined as income subject to various qualifications which state what constitutes income of the bankrupt (s 139L). Clearly this would include any wage or salary payments, or interest earned on savings. Centrelink income also counts including the Centrelink pension bonus for those who have registered before 1 July 2014 and worked past the retirement age. In practice the various retirement payments that are available from Centrelink, including lump sums, would not usually take the bankrupt's income over the threshold amounts.

It also specifically **includes** the following, whether they would come within the ordinary meaning of income or not (s 139L):

- Annuities or pensions paid to the bankrupt from a provident, benefit, superannuation, retirement, approved deposit fund or RSA
- Termination payments/redundancies from employers
- Annuities or pensions paid under a policy of life insurance or endowment insurance
- An amount received by the bankrupt as a beneficiary of a trust as long as it comes from the income of the trust (capital payments would be claimed as assets by the Trustee)

- The value of a benefit given to the bankrupt by any person (as defined by the *Fringe Benefits Tax Assessment Act 1986* (Cth) and in accordance with its rules in relation to exempt benefits as modified by Regulation 33 of the Bankruptcy Regulations), for example:
 - Provision by an employer of a fully maintained motor vehicle and/or computer which can be used for private use. (Note: Living away from home and travel allowances are not counted where it can be shown that the amount paid is fully expended for the purpose it is paid for).
 - A significant benefit provided by a friend or family member (or any other person) such as substantial regular use of a vehicle or free accommodation.
- The value of a loan made to the bankrupt by an associated entity, even if the bankrupt simply directs the payment of the proceeds and does not receive the proceeds.
- The value of any net benefit paid to a third party as a result of work performed by the bankrupt (that is where instead of paying the bankrupt for a job done for the person by the bankrupt, the person pays a relative or friend of the bankrupt as directed by the bankrupt).
- Royalties from intellectual property rights. However, an advance would be an asset.
- Payments received from an income protection insurance policy.
- Instalments drawn from a reverse mortgage may be classed as income in some circumstances.

Note: Where the bankrupt has a salary sacrifice arrangement in place, the *grossed-up value* of the salary sacrifice is used for the income contribution calculation (not the net amount received 'in the hand' by the employee).

The following are **not income** for the purposes of calculating income contributions regardless of whether they might ordinarily be defined as income under s 139L:

- Child support or any other form of maintenance paid for the benefit of children of whom the bankrupt has custody up to the amount that would be payable under the *Child Support (Assessment) Act 1989* (including payments from the Child Support Account established under the *Child Support (Registration and Collection) Act 1988* (Cth)).
- A payment to or for the benefit of the bankrupt under a relevant legal aid scheme.
- Super contributions paid by the employer.
- A payment or amount that the *Bankruptcy Regulations* (see Division 6) provide is not income of the bankrupt.

Note: Where there is partial custody/shared care arrangement, the trustee will determine these on a 'case by case' basis.

An amount will also still be included as income if an amount is deducted from it, or applied to something else, by law (such as the repayment of a repayable government assistance payment), if it is reinvested, accumulated or capitalised, or paid to another person or entity at

the direction of the bankrupt (s 139M).

The income that is likely to be derived, or was derived, by a bankrupt during a contribution assessment period (CAP) is then (s 139N):

1. Reduced by any income tax paid or payable including the Medicare Levy and special levies such as the Flood Levy, in respect of that income.
2. Reduced by any child support payable
3. Increased by any relevant tax refund received during the CAP.

The assessed income will not be reduced by any income tax debt that is provable in the bankruptcy. Tax refunds for years that ended prior to the bankruptcy are not counted as income, but vest in the Trustee as property of the *bankrupt estate*. Tax refunds for income pertaining to a year that started prior to the bankruptcy and ended after the bankruptcy are apportioned on a time basis with the percentage pertaining to the period prior to bankruptcy vesting in the Trustee and the percentage pertaining to the period after the date of the bankruptcy counting as income (see also **Tax and bankruptcy in Chapter 6 Part 1**).

Where payments are made for the maintenance of children under any arrangement other than an assessment under the *Child Support (Assessment) Act 1989* (Cth) (such as a maintenance order or agreement under the *Family Law Act 1975* (Cth)), then the maximum amount that can be deducted is the amount of the assessment that would be made under the *Child Support (Assessment) Act 1989*. Payments of spousal maintenance to ex-spouses (including de facto spouses) do not count as a deduction whether payable pursuant to a court order or not. They are also counted as income if the bankrupt is the recipient, rather than the payer.

At the end of each CAP, a contributing bankrupt is required to complete an income questionnaire disclosing details of income earned from all sources during the past 12 months and includes a question for interest received. It would usually only be in the case of a very high-income earner that the Trustee would take the time to investigate whether the bankrupt had earned any interest on their accumulated savings.

Who can be counted as dependants?

Dependants include anyone who:

- Lives ('resides') with the bankrupt; and
- Is partially or fully dependent on the bankrupt for economic support; and
- Earns less than the amount prescribed in the Regulations – [check the AFSA website to find the current indexed amounts](#).

The residential qualification in practice means 'ordinarily resides' with the bankrupt and thus includes children who attend boarding schools or are boarding with families Monday to Thursday nights in country areas. University students who live away from home whilst partly

dependant on the parents, often receive an income or Centrelink payment well in excess of the above threshold amount and accordingly cannot be regarded as a dependant for income contribution purposes.

What period is income assessed from?

A bankrupt must be assessed on their eligibility to make income contributions (s 139W). A person's bankruptcy is divided into contribution assessment periods (CAPs) of twelve months (or less if the bankrupt is discharged or the bankruptcy annulled within a CAP) (s 139K). The first CAP commences when the person becomes a bankrupt (the date their Debtor's Petition was accepted or a sequestration order was made against them) and is then repeated annually until the bankrupt is discharged, or the bankruptcy is annulled.

The first CAP ends 12 months later and the next CAP begins on the anniversary of the commencement of the first and so on until the bankrupt has been discharged or the bankruptcy annulled. Whilst the *Bankruptcy Act* does not specify when the assessed income contribution amount is to be paid, the Trustee in conjunction with the bankrupt, decide the frequency of the payments. Generally, the contribution payments will align with the bankrupt's paydays – weekly, fortnightly or monthly.

How is the contribution calculated?

The income contribution is payable if the income likely to be earned as assessed by the Trustee is greater than the AITA applicable to the bankrupt (s 139P). If the assessed income is less than the applicable AITA, then no contribution is compulsorily payable, but the bankrupt is entitled to make voluntary contributions if he or she chooses to do so.

The formula for calculating the contribution the bankrupt is liable to pay is simple (once you have identified what income counts and valued benefits, which is not always simple) and is contained in s 139S:

Assessed income – Actual income threshold amount

Assessed income means the amount assessed by the Trustee to be the after-tax income that the bankrupt is likely to derive, or derived, during the contribution assessment period in accordance with the rules above.

Actual income threshold amount means the actual income threshold amount (AITA) assessed by the Trustee to be applicable in relation to the bankrupt when the assessment is made.

The Trustee must make an assessment as soon as practicable after the commencement of a CAP of (s 139W):

- The income the bankrupt is likely to derive in the relevant CAP; and
- The applicable AITA; and
- The contribution payable in accordance with the above formula.

The bankrupt is obliged by the *Bankruptcy Act* to provide documents as proof of income to the Trustee (s 139U) within 21 days of the end of a CAP. In practice the bankrupt will be asked to complete a form indicating the income received in the previous period (where there was one) and the estimated income for the current CAP and attaching the required evidence. The Trustee also has broad powers to request more evidence (s 139V), take into account other information obtained from sources other than the bankrupt (s 139X), and to assume reasonable remuneration for an activity undertaken by a bankrupt even if the bankrupt claims they are not being paid (ss 139Y and 139Z). Generally, the assessment for the first CAP is based on the information in the statement of affairs.

When income is assessed, salary sacrifices, fringe benefits and benefits obtained from other parties (not limited to employers) are counted at the grossed up rate.

The contribution can be reassessed if the bankrupt's situation changes in certain material ways (s 139W). Also, at the end of each CAP the Trustee will compare the estimated projected income figure against the actual income for the CAP and do a re-assessment where there is a significant variation. If the actual income is greater, the amount payable under the re-assessment will be greater than the original assessed amount and the difference between the two amounts will be added to the next CAP.

A bankrupt can also apply to the Trustee for a higher BITA to be used where the imposition of the usual threshold will result in hardship for a variety of defined reasons (s 139T).

Should the bankrupt disagree with any aspect of the Trustee's assessment (including the Trustee's response to a hardship application), then the bankrupt can apply to the Inspector-General for a review of the decision (s 139ZA). Where the bankrupt is dissatisfied with the Inspector-General's review of, or refusal to review, an assessment, an application can be made to the Administrative Appeals Tribunal (s 139ZF). More information about applying for the threshold to be increased due to hardship is included in **Chapter 8**.

The bankrupt should keep the Trustee informed of any fluctuations in income throughout the year. This is because:

- The bankrupt is obliged to do so under s 77;
- If the bankrupt's income increases, the contribution will increase, and the bankrupt may have difficulty paying both the contribution for the following period at the same time as the unpaid balance from the previous period;
- If the bankrupt's income decreases, they will not be paid back any excess contributions

paid – these can only be applied as a credit to a future year's assessment. This means that if there is no future period in which a contribution is payable the bankrupt will never recover these amounts (s 139ZH).

Contributions for any relevant CAP continue to be payable, even after discharge from bankruptcy (s 139R). There is also no time limit on the Trustee's right to make a fresh assessment relating to a previous CAP if fresh evidence comes to light.

Enforcement of unpaid income contributions

The Trustee has wide powers to enforce payment of contributions including garnisheeing of wages or bank accounts under the Act during bankruptcy, without the need to obtain a court judgment. Also, the Trustee can take enforcement action in court after discharge from bankruptcy to collect unpaid contributions.

Failure to pay contributions is also grounds for the Trustee to object to the bankrupt's discharge from bankruptcy (s 149D(1)(f)) and is quite often used by Trustees particularly in relation to high income earners. Whilst not stated in the Act, the Trustee will usually withdraw the objection to discharge upon receipt of the arrears if there are no other grounds for an objection. Where the bankrupt is not discharged, then the requirement to pay income contributions continues, increasing the total amount payable. The Trustee will warn the bankrupt prior to the expected date of discharge, of the consequences of having arrears of income contributions immediately prior to the date the bankrupt would otherwise be due to be discharged.

In any situation where the bankrupt has repaid (by contributions and/or the realisation of assets) more than the amount of the debt plus the costs of administering the estate (legal costs, trustee remuneration and expenses) then the bankruptcy can be annulled by the Trustee and no court application is required.

More information is included in **Chapter 8** of this Toolkit about the Trustee's powers in relation to assessing income and options in relation unpaid contributions.